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Vol. II

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION, PETITIONERS,

vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 20, 1942.

CERTIORARI GRANTED OCTOBER 12, 1942.

SUPREME COURT OF THE UNITED STATES

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VOL. II

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[fol. 1] IN DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA, AT CHARLESTON

In the Matter of FIDELITY ASSURANCE ASSOCIATION, Debtor

Proceedings for Corporate Reorganization, No. 4514

Statement of Evidence—Filed September 15, 1941

Before Honorable Ben Moore, United States District Judge, on Tuesday, the 5th day of August, 1941

APPEARANCES

Messrs. Townsend & Townsend (Mr. T. C. Townsend and Mr. Hillis Townsend), Charleston, West Virginia, Counsel for Central Trust Company, Trustee.

Mr. James R. Fleming, Fort Wayne, Indiana, Counsel for the Debtor.

Messrs. Justin N. Reinhardt, Edward C. Jaegerman and John P. Moore, Washington, D. C., Counsel for the Securities and Exchange Commission.

Mr. Allen H. Blondy, Detroit, Michigan, Counsel for Contract Holders Paul V. Lundstedt and Lelia Lundstedt.

[fol. 2] Mr. Austin V. Wood, Wheeling, West Virginia, Counsel for Edward W. Driehorst; H. C. Ogden, Trustee for Frances Ogden Stubblefield; H. C. Ogden, Trustee for Margaret Lawson Stubblefield; Charles E. Bates, Trustee for Eugenia G. Bates; Ohio Valley Lithographing Company; Mary V. Nager; Mrs. A. L. Jones; Edward C. Jepson; George C. Dannenberg and George S. Kender, all of whom are face-amount certificate holders and appear in their representative capacity representing all those similarly situated;

Mr. Raymond Huwe and Mr. John J. Rivers, Cincinnati, Ohio, Counsel for A. Clyde Ross, Trustee for Dorothy E. Ross, and A. Clyde Ross, Trustee for Shirley J. Ross of Cincinnati, Ohio; and Benjamin M. Ross of Fort Wright, Kentucky, on behalf of their trust and themselves and all others similarly situated;

Mr. Rudolph K. Schurr, St. Louis, Missouri, Counsel for Dewey S. Godfrey, Receiver for the Missouri policy holders.

Mr. Rickard H. Lauritzen, Madison, Wisconsin, Counsel for the Banking Commission of the State of Wisconsin and representing Charles R. Fisher, Commissioner of Insurance and Permanent Receiver in and for the State of Iowa.

Mr. Edmund Burke, Springfield, Illinois, Counsel for S. Leigh Call, Receiver in Illinois.

Mr. W. F. Gray, Springfield, Illinois, Assistant Attorney General, State of Illinois, representing the Secretary of State and the Treasurer of the State of Illinois.

Mr. Dorr E. Warner, Cleveland, Ohio, Counsel for Bertha Thornton, Victor H. Salkeld and G. W. Allen, contract holders.

Mr. Earl B. Swarner, Kansas City, Kansas, Counsel for V. M. Huffman, Securities Commissioner of the State of Kansas.

[fols. 3-23] Mr. Dale Dunifon, First Assistant Attorney General, Mr. David M. Spriggs and Howard Bernstein, Assistant Attorneys General, Columbus, Ohio, Counsel for the Treasurer of the State of Ohio

Mr. Fyke Farmer, Nashville, Tennessee, Counsel for L. H. Brocks, A. L. Goldberg, Jr., and Frederick Leake, contract holders.

Messrs. Price, Smith & Spilman (Robert S. Spilman, Jr.), Charleston, West Virginia, Counsel for George Melcher, R. E. McDonald, W. W. Fuller, C. E. Sanders and Lee Reeder, Protective Committee of the Missouri contract holders.

Mr. Clarence W. Meadows, Charleston, West Virginia, Attorney General of the State of West Virginia, Counsel for Edgar B. Sims, State Auditor and Ex Officio Insurance Commissioner of the State of West Virginia.

Mr. Ross B. Thomas, Charleston, West Virginia, Counsel for H. Isaiah Smith and Ross B. Thomas, Receivers of the Debtor, appointed by the Circuit Court of Kanawha County, West Virginia.

Messrs. Koontz & Koontz (J. Campbell Palmer III), Charleston, West Virginia, Counsel for H. Isaiah Smith and Ross B. Thomas, State Court Receivers of Fidelity Assurance Association.

. . . . . .

[fols. 24-39] STATEMENT RE OBJECTIONS

The Court: Now before we proceed with this other matter we have mentioned, I notice that Section 162 of the act

provides that the court may at this hearing hear objections to the retention in office of the Trustee on the ground that it is not qualified, or not disinterested. Is there any such objection as that to the Trustee, or any objection of any kind to the retention of the Trustee?

* * * * * * *

[fol. 40] A. K. PARKER, JR., having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name to the Court, please.

A. A. K. Parker, Jr.

Q. Where do you live?

A. I live at Welch, in McDowell County; that is my [fol. 41] legal residence.

Q. What is your official position?

A. I am a bond custodian of the State of West Virginia.

Q. And in what department are you situated?

A. West Virginia State Treasury Department.

Q. And you are a deputy under the State Treasurer of the State of West Virginia?

A. Yes, sir.

Q. And you have the official title of bond custodian; is that right?

A. Yes, sir.

Q. Particularly what securities, and for whom are you custodian?

A. Particularly for the Workmen's Compensation Fund, State Interest and Sinking Fund Commission, Department of Public Safety, West Virginia State Board of Control, and certain insurance companies, the Conservative Life Insurance Company of Wheeling, the George Washington Life Insurance Company of Charleston, the Investors' Syndicate of Minneapolis, Minnesota, and the Fidelity Assurance Association of Wheeling, West Virginia.

Q. Do you have securities, then, in your possession owned [fol. 42] by the Fidelity Assurance Association, the debtor in this case?

A. Yes, sir.

Q. How long have you occupied this position, Mr. Parker?

A. About five and a half years.

Q. How long have you had the securities of the Fidelity in your possession?

A. Five and a half years.

Mr. Palmer: If the Court please, I want to object to the witness' answers on the question of the securities being owned by the Fidelity Assurance Association, on the ground that that is a conclusion of law, unless more fully explained as to the witness' knowledge of the ownership.

The Court: Well, the Court knows that is a controverted question. Overruled. (Exception.)

Mr. Fleming:

Q. Was that when you came into this official position?

A. Yes, sir.

Q. And they have been in your custody ever since?

A. Yes, sir, in the joint custody of two custodians.

Q. Will you explain that to the Court, please?

Mr. Lauritzen: Mr. Fleming, do you mean the joint cus-
[fol. 43] tody part?

Mr. Fleming: Yes.

A. Well, by law two custodians are delegated to take care of the securities as a safeguard in the matter, more than anything else. Two custodians are delegated by law to take care of the securities on deposit with the State Treasury Department, and I am one of them, and Mr. W. R. Shaw is the other.

Q. Where are those securities kept?

A. You mean of the Fidelity?

Q. Yes.

A. They are kept in the state deposit vault of the Kanawha Valley Bank.

Q. And how long have they been there?

A. Ever since I have held this position.

Q. Five and a half years?

A. Yes, sir.

Q. Generally of what do the securities in your possession of Fidelity consist?

A. FHA mortgages, notes, certificates of interest in real estate properties, bonds, and I believe those are the major classifications.

Q. And particularly bonds, what class or character of
[fol. 44] bonds?

A. Real estate obligations, public utility bonds, railroad bonds and a small percentage of United States government bonds.

Q. During the five and a half years that these securities have been in the custody of yourself, has the character of them changed from time to time, or have they remained constant?

A. Well, my answer to that question is this: our duties are strictly custodial, and we do not inquire into the character of the assets or as to their value. That is determined by the Auditor of the State of West Virginia. We simply accept the securities and keep them in safekeeping.

Q. Now, what is the position of the Auditor of the State of West Virginia in reference to the Fidelity securities?

A. Well, perhaps he can explain it better, but I will put it this way: when securities are to be deposited, or withdrawn—that is, formerly; there have not been any exchanged for some months—the securities are turned over, that is, I mean the schedule covering the securities is turned over to the Securities Division of the Auditor's [fol. 45] office.

The Court:

Q. Turned over by whom?

A. By the representatives of Fidelity Assurance Association. The Securities Department examines the schedule to see the value of the assets named on the schedule. Then the schedule is approved in its entirety by the State Auditor. The procedure then is to go to the vaults of the Kanawha Valley Bank, where the securities usually, if they are to be deposited, have been shipped in. Then we check the securities against the schedule, which has been approved by the State Auditor, and simply deposit them to the accounts named on the schedule.

Mr. Palmer: May I make a suggestion and ask if it would be saving time in the hearing if we could stipulate that these securities are in the custody of this gentleman by virtue of certain West Virginia statutes, and agree upon those and perhaps save considerable proof, the statute referred to being Chapter 33, Article 9, Section 3, relating to the Auditor of the State, and Chapter 12, Article 5, as amended, of the Code of West Virginia?

The Court: I would prefer to have the facts brought out just as they are.

Mr. Fleming:

Q. Have you endeavored to evaluate these securities of [fol. 46] Fidelity in your custody?

A. No, sir, I have not attempted to evaluate them. The evaluation is made by the Securities Division of the Auditor's office.

Q. And who is the head of that division?

A. Mr. Edgar B. Sims really, but Mr. Robert Brown has active charge.

Q. Mr. Brown has charge of that?

A. Yes, sir.

Q. State whether or not Mr. Brown is charged with the duty, under the law, of evaluating those securities.

A. I can only say that I believe he is.

Q. Now, has the status or location of these securities changed within the past several months?

A. No, sir.

The Court:

Q. Within the past several months?

A. The principal amount on deposit changed within the last six months, but the status and location have not; they are the same.

Mr. Fleming:

Q. Will you explain that; if there has been a change will you just explain the change?

A. Well, in the past, although the account is, I think, as I say, frozen, and you will know what I mean by that; but in [fol. 47] the past securities were being constantly deposited and withdrawn from time to time. Naturally the net amount of the assets on deposit will vary according to those withdrawals and deposits.

Q. Would it vary materially?

A. Yes, sir, it has varied materially in the last six months.

Q. How much would you say?

A. May I refer to a paper I have?

Q. Yes.

The Court: Let us fix that as the first six months before June 7th.

Mr. Fleming: Yes, your Honor, I am going to.

A. That would be December 6th. Now, this figure gives the par or face amount of the securities on deposit on December 6, 1940, which was $17,710,375.50.

Q. On December 6, 1940?

A. That is correct.

Q. On June 6, 1941, what was the amount?

A. $16,338,283.68.

Q. And for each month between those dates?

A. On January 6, 1941, $17,629,075.50; February 6, 1941, $17,290,325.50; March 6, 1941, $12,990,425.50; April 6, 1941, [fol. 48] $15,715,883.68; May 6, 1941, $15,715,883.68.

Q. And June 6th?

A. I will repeat that: $16,338,283.68.

Q. Now, during this period, from December 6, 1940 to June 6, 1941, have there been interest payments or dividend payments upon these securities?

A. Well, I do not have the accurate information available, but our duties with the securities are periodically—usually once a month—to clip the coupons on all securities not in default. Those are turned over to the Fidelity Assurance Association and, of course, they are taken back to Wheeling with them and collected.

Q. And did you clip these coupons on these securities each month during this period?

A. No, sir.

Q. You did not?

A. I don't believe that the coupons have been clipped since about May 15, 1941.

Q. Was that when a local receivership occurred?

A. Just about that time; yes, sir.

Q. But prior to that time, what was done about that?

A. Prior to that time the coupons were clipped regularly once a month.

[fol. 49] Q. And what was done with them?

A. They were turned over usually to Mr. C. E. Smith, the representative of the Fidelity. That is, they were turned over to Mr. Smith, and Mr. Smith mailed them by registered mail back to Wheeling, and I believe they were collected through the local banks in Wheeling.

Q. And had that practice been followed through the entire time you had had these securities in your possession and custody?

A. Yes, sir; that is correct.

Q. I don't believe you stated where the securities were actually located, in what county, state and city; did you?

A. In the City of Charleston, Kanawha County, West Virginia, in the vaults of the Kanawha Valley Bank.

Mr. Fleming: You may cross-examine.

Cross-examination.

By Mr. Palmer:

Q. Mr. Parker, you are employed by the State Treasurer of West Virginia?

A. Yes, sir; that is correct.

Q. And as such employee, your only dealings with these bonds were as an employee of the State of West Virginia: [fol. 50] is that correct?

A. Yes, sir; that is true.

Q. And isn't it a fact that these bonds are deposited with the Treasurer of West Virginia by virtue of two provisions of the statutes of West Virginia, namely, Chapter 33, Article 9, Section 3, requiring a deposit to be made with the Auditor of the State; and Chapter 12, Article 5, as amended, requiring that that deposit be made with the State Treasurer; is not that correct?

A. I imagine that is correct; yes, sir.

Mr. Reinhardt:

Q. Well, do you know?

A. You mean do I know?

Q. Do you know whether that is correct?

A. I know that such deposit is required; but I do not know what section of the code it is, not from memory.

Mr. Palmer:

Q. As I understand, you know that what I have recited is correct, but you are not certain those particular sections are the exact sections of the code?

A. That is right.

Q. And you further know, do you not, that at the last session of the Legislature of West Virginia, had early in the year 1941, that Chapter 12, Article 5, requiring the deposit of certain funds, such as these bonds, with the State Treas- [fol. 51] urer was amended so that the Board of Public Works may now assess a premium or fee for that custody,

which goes into the general revenue of the State of West Virginia?

A. Yes, sir.

Q. Are you also familiar with the fact that in the statutes of West Virginia, Chapter 33, Article 9, Section 10, particularly these securities are deposited with the State of West Virginia, in trust for the benefit of contract holders?

A. Yes, sir, I understand that.

Q. And are you further familiar with the statutes of West Virginia to know that the State Auditor is Ex Officio Insurance Commissioner of the State?

A. Yes, sir.

Q. And that one person is Edgar B. Sims?

A. Yes, sir.

Q. And that the statutes provide in certain cases that the Auditor of the State, as Ex Officio Insurance Commissioner, can in the case of any insurance company take the assets of that insurance company and administer it for the benefit of its creditors?

A. Yes, sir.

Mr. Fleming: The debtor objects for the reason that [fol. 52] it presents purely a legal question and is not proper cross-examination.

The Court: I do not see where this adds to the Court's information, but I am going to let you go into that to a reasonable extent, if you wish. (Exception.)

Mr. Palmer: I think Mr. Fleming is probably right, your Honor, and under our laws of West Virginia, where the Court takes judicial knowledge of state statutes, I don't think we will be required to go any further into this.

Mr. Reinhardt: I was going to ask, your Honor, whether this Court does take judicial notice of those statutes, and I have in mind specifically not only the statutes of West Virginia, but also, if it become important in the course of this proceeding for the record to contain the statutes of other states in which deposits have been made, and I wondered what the situation on that is; whether or not they have to be physically introduced in evidence.

The Court: The attorneys had better satisfy themselves on that legal question.

Mr. Farmer: I think it is pretty plainly settled that the federal courts will take judicial notice of the statutes without proving them.

Mr. Palmer: I think we are all agreed on that, gentle-
[fol. 53] men, so that there will be no controversy about it.

Q. Mr. Parker, your custody of these bonds and your entire control and possession and dealing with them are controlled entirely by the state statutes of West Virginia, of which state you are an employee; is that correct?

A. Yes, sir.

Mr. Lauritzen:

Q. Mr. Parker, are you generally familiar with the individual securities held in this deposit, concerning which you have testified?

A. Well, I don't say that I could say accurately, but I believe I could recognize most of them if you named them, whether they were held or not.

Q. Can you tell us whether those securities are in bearer form, or whether they are in some other form.

A. They are for the greater part in bearer form; however, some of them are not, and our office is on record as notifying the State Auditor to that effect.

Q. And do they bear the endorsements of the officers of Fidelity in blank?

A. No, sir, not invariably.

The Court:

Q. You said you had notified the Auditor to the effect that some of them were not in bearer form. Explain that.
[fol. 54] A. Very often we will receive securities of the Fidelity Investment Association, of stock certificates that will be made out to the Fidelity Investment Association and will not be endorsed when placed on deposit with us. We have made notes to that effect on our various audits and consider it necessary to notify the Auditor that we consider it to be good practice to have those certificates endorsed. However, I consulted an Assistant Attorney General, and he said that probably such endorsement could be forced in event of liquidation.

Q. How much of the deposit is in that form, what percentage?

A. Your Honor, I don't believe I could say accurately: I would say possibly three to five per cent.

Mr. Lauritzen:

Q. Are endorsed or are not?

A. Are not endorsed. I don't know exactly; that is just a guess.

Q. Do you know what percentage of the securities consist of bearer bonds?

A. A very large percentage do.

Q. From your knowledge of securities, can you tell us whether, if these securities on deposit here should be lost, they are the type of securities that might be replaced [fol. 55] by Fidelity by putting up a bond of some kind with the concern issuing those securities?

A. I don't think that a bearer bond can usually be replaced, because that is a negotiable instrument and is just payable to bearer. It could be lost and, well, it is just lost, just like a thousand dollar bill.

Q. And what about those that are not bearer securities?

A. Well, that would be a little different proposition. They would not be of any value if they ever fell in any other hands, unless the endorsement could be forged or was properly assigned or endorsed.

Q. Mr. Parker, you mentioned certain transfers of securities that took place from time to time. Can you tell us generally whether the securities that you now have on deposit are, with respect to those identical securities, the same securities that you have had for a six months' period prior to June 6, 1941?

A. Those were first of all, I might say, not transfers. It was either a withdrawal or a deposit.

Q. By Fidelity?

A. For the main part, yes, sir. However, the major part of the securities have been held for a very long time. [fol. 56] Bonds will be called at times. At times a bond will be extended. It doesn't have to be sent back to have coupons taken care of and so forth; but for the main part they are the same securities that have been on deposit for the last six months.

Q. When you say "for the main part", can you be more specific, and tell us in what amount they are the same securities as have been there for six months?

A. Well, possibly it would be all right to mention one fact: there was a large amount of securities that were with-

drawn, as I have noted on a statement (referring to record) some time the latter part of February, and that was a material amount; that was about $4,000,000.

Q. Were withdrawn?

A. Yes, sir.

Q. And subsequently replaced by others, or not replaced?

A. The securities withdrawn were the Marston and Paull Companies, which I understand—I do not have any definite knowledge, but I understand—were set up by Fidelity to administer certain real estate bonds. The real estate bonds, as I understand it, were the underlying bonds behind the Marston and Paull corporation securities. Then [fol. 57] when the Marston and Paull Companies were dissolved, the underlying securities, by order of the State Auditor, were returned to the State of West Virginia, and are now on deposit with us.

Q. Mr. Parker, are you in position to tell us whether the major portion of all Fidelity's assets were ever located here in Charleston for a period of six months prior to June 6, 1941?

A. Well, of course, we are only interested in the part of the securities that the State of West Virginia holds; I mean as custodian. However, right now I could not tell you the figure on the total assets for the Fidelity, because it is really none of my business; but if you can tell me the total assets, I will tell you whether I think so, or not.

Q. You don't know the total assets, yourself?

A. No, sir, I do not.

Q. Can you tell us in dollar amounts within a six months' period prior to June 6, 1941, how many securities were continuously here on deposit in Charleston, owned by Fidelity, or originating from Fidelity?

The Court: Mr. Lauritzen, do you mean by that question, securities that were here that whole period of six months, and not withdrawn?

[fol. 58] Mr. Lauritzen: Not withdrawn or exchanged.

A. Well, I have given you the figures, the par amounts of securities held on the 6th of each month. Would not your question be answered by taking an average of those amounts shown?

Q. No.

The Court: What he means is, what particular securities in the aggregate were here all the time, as distinguished from those that were exchanged from time to time, or those that were withdrawn, replaced and so forth.

A. Well, of course, the major withdrawal was the $4,000,000 approximately, that I mentioned. In replacing those with some $2,900,000 they were put back, and if you leave those out, the major part of the remainder of the securities was here all the time. I think that was the only major exchange that was made. The other exchanges, as I said before, may have been temporary for the collection of interest or to be amended.

Q. That would have been about twelve and a half million, then?

A. Well, roughly that, yes, sir.

Mr. Lauritzen:

Q. When you speak of amount, do you mean face amount [fol. 59] of the securities or market value of those securities?

A. Face amount, or par value.

Q. Have you any means of telling us, within a six months' period prior to June 6, 1941, in dollars, the market value of securities that Fidelity had on deposit here?

A. No, sir; that is none of my business.

The Court:

Q. Whose business is it to keep that appraised?

A. Your Honor, that is the duty of the Securities Division of the Auditor's office, I understand.

Mr. Lauritzen:

Q. Are you familiar with the fact that the market value of these securities was considerably less than the face amount thereof during the six months' period prior to June 6, 1941?

A. I could not say so in the aggregate. Of course, some bonds that I am familiar with, I know that they are less, the par value, in some cases.

Q. You have no information on that subject?

A. No, sir.

Mr. Lauritzen: That is all I care to ask.
The Court: Is that all with this witness?

Mr. Reinhardt: Just one question, your Honor.

[fols. 60-64] Q. Are you an attorney?
A. No, sir.
The witness was then excused.

* * * * * * *

[fol. 65] Mr. Lauritzen: If the Court please, I have no desire to go further with seating arrangements, or anything of that sort, but I think there is one thing we are interested in knowing, and that is whether the Trustee herein, being an officer previously appointed by the Court, is assisting and aiding the petitioner in maintaining the allegations of his petition. If that is true, we would wish to challenge that as being wholly improper on the part of the Trustee, the Trustee having no interest whatever in taking part in a controversy presently arising between the petitioner and the answering creditors and intervenors.

Mr. T. C. Townsend: Do you want to provide special seats for somebody else; is that the idea?

Mr. Lauritzen: It is not the seating I object to, but I think we are entitled to a statement of your position in that regard, as to whether you are taking such a part.

The Court: The Court is going to permit all counsel to sit wherever they please, and to take such part as they deem advisable.

[fols. 66-69] Robert F. Brown, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. Give the Court your name, please.
A. Robert F. Brown.
Q. Where do you live, Mr. Brown?
A. 40 Poplar Avenue, Wheeling, West Virginia.
Q. Do you occupy some official position at this time?
A. Yes, sir.
Q. What position?

A. Deputy Securities Commissioner of the State of West Virginia.

Q. Under whom do you work?

A. Under Edgar B. Sims, who is State Auditor and Ex Officio Securities Commissioner.

[fol. 70] Q. Did you use Haskins & Sells' audit in making your evaluation?

A. No, not entirely.

Q. Who made a record in your office, if there was a record made?

A. I don't know what date you are speaking of.

Q. Well, around December 6, 1940.

A. That, I believe, was done by the State Auditor and the Deputy Insurance Commissioner and Mr. Smith of the insurance department.

Q. Well, are those gentlemen, or either of them, in town?

A. No, sir.

Q. Will they return soon?

A. I think so.

The Court: Let me ask a question:

Q. Mr. Brown, you said evaluations were made on the basis of the market value of the securities.

A. Well, whenever we made a check-up, we usually had three values: the par value, of course and the Auditor's valuation and the market value.

Q. Was the Auditor's valuation and the market value the same?

[fol. 71] A: No, sir.

Q. Which was higher?

A. The Auditor's valuation was higher.

Q. Why?

A. Well, the point was, as I understood it, that at no time did a corporation such as this—at no particular time did a corporation such as this have to deposit all of its securities on that particular date and, therefore, that the market value was a little severe.

Q. You mean if the security was quoted, say, at 50 on the market on a particular date, that you would value it, for the purposes of the Auditor, at 60, or some higher figure?

A. We had a regular formula, your Honor. Securities which were not in default were given a par value. Those which were in default were given the market value.

Q. Regardless of whether a security not in default had a market value of par, it was given the par value?

A. If it were not in default.

Q. Were there many securities that were listed on the market at a figure below the market value, those that were not in default, I mean?

A. There were some; I could not say with any degree of [fols. 72-76] certainty.

Q. Well, what about stocks; were there any stocks?

A. Yes, there were preferred stocks. They were always valued at the market.

Q. It is only with respect to bonds, then, that you mean to say that those that were not in default were always listed at par?

A. That is right; yes, your Honor.

* * * * * * *

[fols. 77-114] Mr. Lauritzen: If the Court please, I would like to record an objection to the Trustee taking part in this trial that is now taking place between the debtor, who is the petitioner, and these answering creditors.

The Court: Overruled. (Exception.)

[fol. 115] Frank J. McNulty, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. You may state your name to the Court.

A. Frank J. McNulty.

Q. Where do you live, Mr. McNulty?

A. Wheeling, West Virginia.

Q. What is your occupation?

A. I have the title of Vice President of Fidelity.

Q. Are you actively employed in the work of that organization, Mr. McNulty?

A. Yes, sir.

Q. In what capacity?

A. I am now employed by the Trustee.

Q. What are you doing?

A. Well, I am more or less supervising the correspondence to contract holders and other incidental duties that are assigned by the Trustee.

Q. In other words, you read the correspondence that comes in from the contract holders from all over the country and reply to it; is that right?

A. Yes, sir; that is, I more or less supervise that work.

[fol. 116] Q. And you are familiar with that work?

A. Yes, sir.

Q. How long have you been doing that?

A. Well, I was assigned that job originally by the Receivers when they were appointed.

Q. That is, the State Court Receivers?

A. Yes, sir.

Q. And you have been doing it ever since?

A. Yes, sir.

Q. That covers what period, Mr. McNulty?

A. Well, since about April 11 to date.

Q. When did you first enter the employ of Fidelity?

A. In August, 1922.

Q. What did you do at that time?

A. I was more or less in a clerical position.

Q. In the office, you mean?

A. Yes, sir; in the office.

Q. At Wheeling, West Virginia?

A. At Wheeling, yes, sir.

Q. Was the new building built at that time?

A. No, sir.

Q. You were still in the old building?

A. Yes, sir.

Q. And where was that situated in Wheeling?

[fol. 117] A. 1229 Main Street, Wheeling.

Q. Do you remember the size of the company at that time, from an assets viewpoint?

A. Well, I don't remember definitely. I would say approximately around $2,000,000.

Q. And who was head of the company at that time, if you remember?

A. Mr. W. B. Irvine was President.

Q. Was he one of the founders of the company?

A. Well, he was one of the original incorporators, I believe.

Q. Do you know how long he had been with the company?

A. No, I could not say.

Q. Was he in active charge of the company at that time?

A. He was more or less serving in a part-time capacity.

Q. Who was in general charge of the business affairs?

A. Mr. Russell B. Irvine.

Q. Was that his son?

A. Yes, sir.

Q. What was the business of the company at that time?

A. It was the issuance of what we called the Special Income Contract.

Q. And is that the only type of contract that had been [fol. 118] issued up to that time?

A. Well, we had the—on our books what we called the old ten-year series, and the C and D series.

Q. Those were older series?

A. Yes.

Q. Do you know whether there are any of those series in existence now?

A. I don't—if there are any in existence, I don't know it. There are one or two minor amounts that have never been settled due to the inability to locate the original owners.

Q. But there are no active accounts in those series?

A. No, sir.

Q. And those are the series preceding the issuance of what is known as the Special Income Contract; is that right?

A. Yes, sir.

Q. Do you know how long the Special Income Contract had been sold or issued by the company prior to the time you came with it?

A. No, but I would say approximately it was started either in 1920 or 1921.

Q. And how long did the company continue to sell that contract, Mr. McNulty?

A. Well, up to 1925; might have included a part of 1925, I am not sure.

[fols. 119-120] Q. And are there still some contract holders in that classification who have that contract now?

A. Yes, sir.

Q. Do you know the number of them, or about the number?

A. Well, I think it is about 900-and-some-odd.

Q. About 900?

A. Yes. Now, that includes in different statuses; includes some of them that have not matured and some of them that may be considered as paid-up contracts.

* * * * * * *

[fol. 121] Q. Now, I believe you told us there were about 900 contract holders of the Special Income Contract?

A. Yes, sir.

Q. (The last question and answer on page 119 was then read by the reporter.)

Q. In other words, the liability existing as to each of those 900 contract holders under the Special Income Contract?

A. Yes, sir.

Q. Mr. McNulty, I hand you what has been marked Debtor's Exhibit No. 1, which you may examine and tell the Court what that is, if you will, please.

A. This is a Special Income Contract of Fidelity Investment Association.

Q. Is that the type of contract that was uniformly issued by the company to Special Income Contract holders?

A. Yes, sir.

Q. And this particular contract, what type contract is that in amount?

A. Well, this is a $2,000 face value.

Q. What other types in amount were issued, if you know, [fol. 122] from that classification of contract?

A. They were issued in two, four, six, ten, twelve and twenty thousand; issued in denominations of two, four, six, ten, twelve and twenty thousand dollars.

Q. How long did the company continue to issue that contract, if you know?

A. Well, it was to 1925.

Q. Through 1925?

A. I don't know whether it went through the full year 1925; approximately that.

Q. Did the company cease to issue that contract after that?

A. Yes, sir.

Q. Do you know how the company happened to quit issuing that contract?

A. Well, at that time there was some litigation with the State of Illinois in connection with the terms of the contract, and we were suspended from selling that particular contract during that litigation.

Q. In Illinois?

A. Yes, sir.

Q. In any other state?

A. Well, it was suspended in all states and then the [fol. 123] new contract was considered.

Q. Do you know why or the reason that litigation arose? Could you explain it to the Court?

A. Well, as I recall it was brought by the Secretary of State of Illinois.

Q. Do you remember why they objected to the Special Income Contract?

A. No, I don't recall the full details, but I think it was—it was my understanding it was on the grounds it was possibly misleading.

Q. But you don't know what provision?

A. No, I don't recall that exactly.

Q. Then was another contract formulated?

A. Yes, sir.

Q. Do you know who formulated that?

A. No, I don't.

Q. You did not have anything to do with it?

A. I did not have anything to do with it.

Q. Then when the company started selling contracts again you sold a different type contract?

A. Yes, sir.

Q. What was that type contract? What did you call it, if it had a name?

[fol. 124] A. The Special Annuity Contract.

Q. I now hand you what has been marked Debtor's Exhibit No. 2, which you may examine and state whether or not that is a specimen copy of the Special Annuity Contract concerning which you have just testified.

A. Yes, it is.

Q. And is this a specimen copy of all contracts which were sold in this class, except as to amount?

A. Yes, other than the paid-up contracts which were issued in lieu of that original contract.

Q. Will you explain those contracts, please?

A. Well, the paid-up contract was issued in lieu of the original contract, either at the request of the contract holder or in the event of one year's delinquency in making payments a paid-up contract was issued but contained certain values which were improved and retained the same maturity date as the original contract.

Q. Other than the amounts which you have mentioned were the provisions of the paid-up contract identical with

the provisions of the original contract, or were they different, Mr. McNulty?

A. Well, they were substantially the same provisions. It provided for cash values and——

[fol. 125] Q. But the general provisions of the contract were the same, were they?

A. Yes, except that the paid-up contract did not participate in the surplus.

Q. How long did the company continue to issue these Special Annuity Contracts, the form of which you have identified as Debtor's Exhibit No. 2?

A. Up to 1932; it might have included a portion of '32.

Q. Could you tell the Court approximately the amount of money collected by the company, by Fidelity, in the sale of Special Income Contracts?

A. I would have to refer to some records before I could do that.

Q. Do you have those records here?

A. No, I don't have them here.

Q. You don't know how much was paid out under those contracts either, I don't suppose, do you?

A. No.

Q. You say in 1922 is when you went with the company?

A. Yes, sir.

Q. At that time the company had assets amounting to about $2,000,000?

A. That is approximately my recollection.

[fol. 126] Q. And in what form were those assets at that time?

A. Well, as I recall it they were in the form of bonds, securities, cash and the home office building.

Q. Were any of those deposited with any of the state agencies under depository acts at that time?

Mr. Palmer: Objection to the term "state agencies."

Mr. Fleming: I think that term is very general and a very well understood term.

The Court: Overruled. (Exception.)

A. Well, I don't recall; I could not say because I don't know.

Mr. Fleming:

Q. When the company abandoned the sale of Special Income Contracts that was about 1925?

A. The Special Income Contracts, yes.

Q. Do you remember what the assets were, or about what they amounted to at that time?

A. No, I don't recall.

Q. Had they increased, if you remember?

A. Oh, yes, I would say they had increased substantially at that time.

Q. Do you know whether any of the securities were deposited with any state agency at that time?

A. Well, I can't say for certain but I believe they [fol. 127] were.

Q. Do you remember in what states?

A. I would say they would be deposited in West Virginia.

Q. When did Fidelity begin the sale of the Special Annuity Contract?

A. I think the first sales were approximately 1925.

Q. That is, the sale of contracts was not suspended very long?

A. No, it was just a temporary time, a short time.

Q. Do you remember how long?

A. Oh, several months.

Q. Then how long did the sale of Special Annuity Contracts continue?

A. Up to and possibly including part of the year 1932.

Q. Do you remember what the assets of Fidelity were at the time you ceased selling Special Annuity Contracts?

A. I can't say but I believe they were in excess of $25,000,000.

Q. The company had grown then?

A. Yes, sir.

Q. And that was in 1932?

A. 1932.

Q. 1932?

[fol. 128] A. Yes.

Q. What were the assets of the company, or approximately the assets, say in 1929, if you remember?

A. I would say approximately around $20,000,000 but I can't say for certain.

Q. Do you recall how the depression—you remember the depression of course, the beginning of it, don't you?

A. Yes, sir.

Q. In the years 1930, 1931 and 1932, do you remember how the depression affected the value of the assets of Fidelity, Mr. McNulty?

A. Well, it did naturally have an adverse effect.

Q. Now at that time what were the assets of Fidelity invested in, if you know?

A. In bonds; possibly there might have been some small investment in stocks at that time.

Q. Any real estate?

A. There were some real estate bonds, I would say, I am not certain as to the actual real estate but I don't believe at that time there was, outside of the home office building.

Q. And you think during that period the assets of Fidelity were of the value of approximately $20,000,000; is that [fol. 129] right?

A. Yes.

The Court: I think he said $25,000,000 in 1932.

The Witness: Yes, $25,000,000 in 1932, but I can't say that with any certainty.

Mr. Fleming:

Q. What capacity did you have with the company during that period, say from 1930 to 1932?

A. Assistant Secretary.

Q. And you had other duties other than that, did you?

A. Yes.

Q. What did you actually do?

A. Well, the preparation and filing of various reports to the state departments, some tax returns and more or less of the character of general activities in that connection.

Q. Do you remember who was head of Fidelity about that time, Mr. McNulty?

A. In 1932?

Q. Yes.

A. Late in 1932 Mr. John W. Paull became President.

Q. Who was he?

A. Well, I understand he was formerly Comptroller of the Currency of the United States.

[fol. 130] Q. Did he succeed Russell Irvine?

A. No, Mr. D. A. Burt succeeded Mr. Irvine.

Q. D. A. Burt succeeded Mr. Irvine?

A. Yes.

Q. How did he happen to succeed Mr. Irvine, if you know, Mr. McNulty?

A. I don't know, except by action of the board of directors.

Q. You don't know of any reason for it?

A. No, sir.

Q. Do you know why Mr. Paull succeeded Mr. Burt?

A. No.

Q. What about the business affairs of Fidelity? Had they made progress or had they gone backward?

A. I would say they had made progress.

Q. And how were the sales of Fidelity handled?

A. They were handled through a corporation known as the National Sales Agency, Inc.

Q. Do you remember when that sales agency was incorporated, or about when?

A. I think approximately about 1913, somewhere along there, as I recall.

Q. That was a separate organization?

[fol. 131] A. Yes, sir.

Q. And that organization was paid a commission upon its contracts?

A. Yes, sir.

Q. That were sold?

A. Yes, sir.

Q. Do you recall the time when the sales policy permitted the payment of advance commissions probably to that organization?

A. Yes, sir.

Q. About when did that policy arise?

A. Approximately 1928 or 1929.

Q. And who was head of the sales agency at that time?

A. Fred M. King.

Q. Who was head of Fidelity at that time?

A. I think at that time Mr. D. A. Burt.

Q. How long did that sales agency continue to sell contracts for Fidelity, if you know?

A. I think up until—or part of the year 1935.

Q. And how long a period then did this sales agency sell contracts for Fidelity?

A. Well, from the time that they were incorporated up until approximately 1934 or 1935.

[fol. 132] Q. How many years would that be?

A. Oh, about 22 years.

Q. Did this policy of paying the sales agency advance commissions continue until around 1934 or 1935?

A. Yes, I would say it did.

Q. Until they quit selling contracts for Fidelity?

A. Yes, sir.

Q. Now, during this entire period in which they represented Fidelity were they the exclusive sales agency for Fidelity contracts throughout the country?

A. Well, not for that entire period, but up until about 1925, I think it was, and a corporation by the name of Irving & Sisson of Chicago, Illinois, had the contract for the sale of contracts for the West, the Chicago District, and the National Sales Agency had the eastern part of the United States.

Q. Then those two companies had the exclusive selling contracts with Fidelity?

A. Yes, sir.

Q. Now did there come a time when Fidelity quit selling the Special Annuity Contract?

A. Yes, sir.

Q. When was that?

[fol. 133] A. In 1932, the early part of 1932.

Q. And how did that happen?

A. I don't know just the exact reasons, but I think it was due to the change in economic conditions and they felt a new type of contract should be developed.

Q. Did the interest rate on these contracts have anything to do with the change at that time?

A. Well, I don't know but I think that that was considered in there.

Q. Do you remember what the interest rate was in the Special Income Contract?

A. It was a 5% contract.

Q. And the Special Annuity Contract?

A. That was 4½%, until the last payment was made and then it was 5% from that time on.

Q. And the next type of contract, what was that?

A. The Series A was a 4% contract compounded quarterly.

Q. When did Fidelity commence selling that contract?

A. 1932.

Q. And how long was that form of contract sold, about how long?

A. Approximately to 1934; maybe including part of the year 1934.

[fols.134-138] Q. I hand you here what has been marked Debtor's Exhibit No. 3, which you may examine and state

whether or not that is the Series A contract to which you have just referred.

A. Yes, sir.

Q. Will you explain why you referred to this as the Series A contract, particularly as the contract bears the title Income Reserve Contract.

A. Well, I can explain why that was definitely called an Income Reserve Series A.

Q. All right, was it for the purpose of classification or separation from the later B, C and D contracts?

A. That was surely the intention of it, in the event of any subsequent issues.

[fol. 139] Q. Then how did you happen to quit selling Series A Income Reserve contracts? That is, if you know.

A. Well, I can't answer that definitely except that it was felt that probably a new contract containing some advantages or benefits that were not included in the former series was needed.

Q. And what was the next series of contract that was issued?

A. That was the Income Reserve Series B.

Q. Now, when did you commence the sale of that series?

A. 1934.

Q. Did you have some difficulty with your sales organization about that time, or did you reshape your sales organization, or what was done, if anything?

A. Yes, at that time I would say that the contract with the National Sales Agency, Inc., was cancelled.

Q. And if there was a large loss or deficiency occurring at that time in connection with that sales organization explain that to the Court, if you will.

A. Well, at that time the agency division was started for the purpose of operating for the National Sales Agency with the intention of all profits accruing through the opera-
[fol. 140] tions of the agency division would be applied on the indebtedness owed to the association by the National Sales Agency, Inc.

Q. Did the National Sales Agency owe the company a large amount at that time?

A. Yes, they did.

Q. Do you remember about the amount?

A. As I recall, at that time it was somewhat over a million dollars.

Q. And did it have any assets, the Sales Agency, at that time?

A. Well, it had some equipment in some of the branch offices.

Q. Of much value?

A. Oh, not of large value. I would say probably twenty-five or thirty thousand dollars.

Q. Was the business or policy of the company in reference to the sale of contracts, all types of contracts, changed about that time?

A. As to the method of sales?

Q. No, as to any additions that were made to the contracts by way of benefits or by way of insurance.

A. Well, by the inclusion of the insurance provision of [fol. 141] the Income Reserve Series B Contract.

Q. That had an insurance provision, did it?

A. Yes, sir.

Q. For all policyholders?

A. No.

Q. Just explain that if you will.

A. That insurance was obtained by the association from a regular reserve life insurance company and it provided that in the event of death of the contract holder after one payment was made that the insurance company would pay to the association an amount sufficient for the association to declare the contract fully paid.

Q. In other words, the insurance company, which was entirely independent from Fidelity, would insure the performance of the contract to Fidelity?

A. Yes, the insurance coverage was handled entirely by the insurance company. Of course, they would require the submission of proof and an application for the insurance.

Q. Was that insurance brought about upon the group principle of insurance without physical examination, or by physical examination?

A. Well, the insurance company could demand physical examination after the age of 50, I think it was, or when [fol. 142] some facts in the insurance application showed that an examination was advisable.

Q. And who paid for that insurance provision?

A. Well, the association paid the insurance company direct the premium.

Mr. Palmer: Another interruption, if you will permit me: I notice you said the insurance policy, in the event of death, provided for a paid-up policy. I think there should be a distinction drawn that that was not, however, the full amount of the face value of the policy, but was a value up to a certain date and then you had to let it rest for ten and a half years in order to get the full amount of the face value. I think the witness can bring that out clearer than I can, however.

Mr. Fleming:

Q. Will you explain the method under which Series B Income Reserve contracts containing the insurance provision were handled?

A. Well, the applicant would submit the application to the insurance company and if acceptable to them they would advise the association that that insurance was acceptable, and that insurance provided that in the event of death of the registered contract holder all remaining unpaid payments at that time would be paid for on a discounted basis [fol. 143] by the insurance company and the original maturity date remained unchanged, of the contract. The estate had the option then at that time of taking the cash surrender value showed by the schedule or leaving the contract there until the original maturity date, at which time they could exercise the same options as the original holder had he lived.

Mr. Palmer: It has been suggested perhaps in further explanation of this copies of the insurance contract should be introduced in evidence so that the exact terms of that could be had, not in contradiction of the witness but in further explanation of this.

The Court: I assume that is Mr. Fleming's intention.

Mr. Fleming: Do we have any of those policies?

Mr. Hillis Townsend: Your Honor, that is in the record as an exhibit in a petition filed by the Trustee.

The Court: Then there is no use putting it in again.

Mr. Fleming: It is not in this record, is it?

Mr. Hillis Townsend: Not in this one today, no.

The Court: You can just refer to it.

Mr. Hillis Townsend: It is in the record as an exhibit to one of the petitions filed by the Trustee.

Mr. Palmer: Can it be identified as being the same insurance policy of which this witness is speaking, so that this [fol. 144] record will show that it is the same one?

Mr. Fleming: If we could have the Clerk get that petition with the exhibit attached to it I would like to have it identified as being the same policy.

The Court: All right, you may do that later. Proceed with the examination.

Mr. Fleming:

Q. I now hand you what the reporter has marked for identification Exhibit No. 4, which you may examine and state whether or not that is a specimen copy of the Series B Income Reserve Contract to which you have just referred.

A. It is.

Q. And is that identical in form with all contracts issued in that series?

A. With the exception of the amounts, the denominations, and the income reserve provided for the issuance of a paid-up contract.

Q. How long were these contracts, Series B Income Reserve contracts, sold?

A. They were sold up until—through December, 1940.

Q. And that was when the company ceased to sell contracts at all?

A. Yes, sir.

Q. Did you issue any other forms of contract after Series [fols. 145-147] B was developed and sold?

A. Yes, we issued an Income Reserve Series D Contract.

Q. How did you happen to issue that contract?

A. Well, the Income Reserve Series D did not have the insurance provision, and some states felt that we could not offer a contract containing insurance without possibly being considered as an insurance company.

Q. That is, in other words, Ohio, Kentucky and some other state——

A. Alabama, yes.

Q. —and Alabama refused to permit you to sell annuity contracts as you had been doing containing the insurance provision?

A. Yes, sir.

Q. When did you first commence selling Series D Income Reserve contracts?

A. That was in 1935.

Q. How long was the sale of those contracts continued?

A. Well, up until December 1940, with the exception of one state; in Ohio it was discontinued prior to that date.

. . . . . .

[fol. 148] Q. Was any other type or character of business operated or accomplished by Fidelity during this entire [fol. 149] period that you were with the company up to the present time?

A. No, sir.

Q. And were there any other types of contracts issued and sold by Fidelity other than these contracts which you have identified as being Exhibits 1, 2, 3, 4, and 5?

A. There was a contract termed the Income Reserve Series C Contract.

Q. Tell us about that.

A. That was issued only in the State of Wisconsin and it was issued in connection with the unemployment set-up that Wisconsin had, and that had been—they adopted this type of contract, or had approved it, as a means of companies investing in that fund for the unemployment fund.

Q. Were any of those contracts sold?

A. Yes.

Q. How many?

A. Oh, there were several hundred of them sold and they were discontinued then when—my understanding is when the federal government adopted the social security that Wisconsin had no further use for their fund, as I understand it.

Q. And are there any of those contracts outstanding now, Mr. McNulty?

A. Yes, I would say there are approximately twenty of them.

[fol. 150] Q. They are all in Wisconsin?

A. Yes, but they are not active contracts now.

Q. Now, as this money would come in from the sale of these contracts what did Fidelity do with the money, if you know?

A. Well, it would be—when the payments came in the contract holders in those cases returned with the money a particular stub which indicated the series and the number of the particular contract, as well as the name and address. They would be sorted then by contract series and the appli-

cation of credit made to the individual account cards and the money, of course, deposited in the bank.

Q. And later were securities purchased?

A. Yes.

Q. And when you first came in did you know who had charge of the purchase of securities at that time, that is, back in 1922?

A. As I recall it, the Investment Committee.

Q. You probably don't remember who they were at that time, do you?

A. No, I could not say.

Q. And was that policy continued down through the years?

A. Yes, the Investment Committee passed on all securi-
[fol. 151] ties, or all investments and the sales of any securities.

Q. Now, in recent years who has handled the purchase of securities?

A. Well, the Investment Committee of course governed the purchase of any security or the sale of any security.

Q. But have you had a special employee or representative who has devoted considerable time to that?

A. Yes, Mr. Hubert F. Young.

Q. Where does he live?

A. In New York State.

Q. Is he a broker?

A. No, he was an employee of the company.

Q. An employee of the company?

A. Yes.

Q. And he devotes all of his time to the company?

A. Yes, sir.

Q. He, as I understand them, recommends the purchase of securities and the sale of securities?

A. That is right.

Q. And then that is either approved or disapproved by the Investment Committee; is that the way the investments of the company have been handled in recent years?

A. Yes, sir.

[fol. 152] Q. Do you know how they were handled prior to the time Mr. Young came into the employ of the company?

A. No, except through the Investment Committee which would have meetings on the type of securities to be purchased, and would authorize an officer to proceed with the purchase or sale of any security.

Q. Did the company at various times own real estate other than their office building?

A. Yes.

Q. I mean, for purposes of investment and profit?

A. Well, as I recall it the real estate that the association did have, other than its home office buildings, was taken over by the foreclosure of mortgage bonds.

Q. And how was that managed?

A. Well, that would be a matter for the Investment Committee.

Q. Well, would it be rented?

A. Oh, yes.

Q. And rental would be collected?

A. Yes, sir.

Q. And was that handled through the general offices in Wheeling or by some private rental agency?

A. I think in some cases it was handled by rental agen-
[fol. 153] cies and others direct by the company itself.

Q. Now, when the securities were purchased by this Investment Committee for the company would those securities from time to time be deposited with various state agencies?

A. Yes, sir.

Q. Do you remember when that situation first arose?

A. Well, as I recall it a deposit was always maintained in the State of West Virginia.

Q. Under the special act under which the company, I understand, was incorporated?

A. Yes, sir; and then in Pennsylvania, in order to qualify there, there was a statutory requirement for a deposit of $100,000, which likewise was made; but as to the dates or time that these various states——

Q. (Interposing): Well, what about other states which from time to time required deposits? Do you remember about that—deposits of securities, I mean?

A. You mean as to the approximate dates?

Q. Yes, just generally. What states were they, first?

A. Well, there was the State of Georgia that had a statutory requirement.

Q. Do you remember about Wisconsin?

A. Yes.

[fol.154] Q. Do you remember when you first commenced to deposit securities in the State of Wisconsin?

A. Approximately around 1930 or 1931.

Q. And what about Illinois?

A. I think about approximately the same date.

Q. Now, as these securities were deposited in the various states under their depository law requirements, were the securities segregated into classes in accordance with whether the securities were purchased by moneys paid in, say on each of these series of contracts which Fidelity had sold, or was selling?

A. Each reserve fund had its own investment which was composed of money received by that particular contract fund.

Q. In other words, the moneys that came in from the sale of each of these classes of contracts which you have identified as Exhibits 1, 2, 3, 4, and 5, were set aside for the security or benefit of those contract holders?

A. Yes, our records were earmarked as to that.

Mr. T. C. Townsend:

Q. What did you say?

A. The securities were so recorded so that each contract fund had its own security.

Mr. Fleming:

Q. And were specific securities purchased from moneys derived from the sales of contracts of each of these classes [fol. 155-162] that went into the securities and then the securities you kept a record of each specific security class; is that right?

A. Yes, sir.

Q. Now, when those securities were deposited in the various states were the securities intermingled or were they kept separate in accordance with the number and amount of contracts existing in those states?

A. Well, as far as our records were concerned they were not intermingled or commingled, but in making deposits with the various states on some occasions the securities belonging to one particular fund would be sent out as a deposit not specifically for that particular fund but to build up the deposit as a whole, to cover the liability in that state.

* * * * * * *

[fol. 163] Q. About how many letters have you received or have been received by the Fidelity from Contract holders, would you say, during that period of time?

Mr. Palmer: That is, from April 11 to the present time?

Mr. Fleming: Yes, to the present time.

A. Well, that would be had to determine because in a great many instances we have had subsequent letters to the first one, and maybe some information was sent out and they [fol. 164] write back again. In some cases the same contract holder has written more than once.

Q. Say from different contract holders.

A. I would say approximately 7500 or 10,000.

Q. Could you tell just generally what states those letters have come from?

A. I could not say that definitely.

Q. Have you read all of those letters yourself?

A. I have not read all letters personally.

Q. In those letters have expressions been made by contract holders in reference to the future of Fidelity?

A. Yes, they have in a great many letters.

Q. And what has been that expression or what have been those expressions?

A. Well, it has been different—there have been quite a variety of expressions.

Q. I mean by that, have they expressed anxiety over the fact that Fidelity might be liq dated?

A. Well, that is possibly one of the main topics of the letters, is their concern over their contracts and what is going to happen to them.

Q. And what has been the sentiment in reference to rehabilitation of Fidelity through reorganization?

[fol. 165] Mr. Lauritzen: If the Court please, I object to that question and the question previously asked, unless it is shown from whom these letters were received and whether in response to a question as to what should be done with the company, and unless we have an opportunity to examine those letters which are, after all, the best evidence of the facts therein contained and which are readily available to the debtor to be produced in this proceeding.

The Court: Well, could you do that? You would not want to examine 10,000 letters, would you? The Court would not permit the delay of this hearing to do that. I think this evidence is proper except that the question seemed to the Court that it was too general as to what was the sentiment. I think this witness ought to give his answer in some proportionate form or some percentage basis, approximately;

that is, as to what proportion of these who expressed themselves wanted reorganization.

Mr. Palmer: Might I make a further suggestion to keep it from being objectionable? To ask the witness what sentiment was expressed really calls for an expression of the witness' opinion as to what was said. Would it not be better to say or to ask what did the letters express from the writers as to whether they desired reorganization or liquidation, [fol. 166] and so forth?

Mr. Fleming: I think that would be proper.

The Court: If you can get it in terms of proportions.

Mr. Farmer: And also what they wrote these creditors, if the Court please. If they led them to think they were going to get their money right away, that is a different thing from having to wait a long time.

The Court: You may cross-examine on that.

Mr. Fleming: Were there expressions contained in these letters or divers of them in reference to the rehabilitation or reorganization of Fidelity?

A. Yes, although not a great many. The subject or the word reorganization was not used. A great many cases the people said they would withhold making further payments on their contracts until something definite was worked out on it, and other cases they requested paid-up contracts until something definite was worked out.

Q. Were there expressions of willingness to continue to pay on the contracts in a number of letters?

A. Yes.

Q. And what has been your experience during the past three months, three or four months, since April 11, 1941, in reference to the continuation of various contract holders to [fol. 167] pay under their contracts?

Mr. Palmer: May we ask that that be divided into two periods? The period under the state court receivership and the period under this Court's trusteeship, for the reason there may be or may not be—I don't know—a change in the writers during that period which might make some reflection as to the express wishes of those persons, if the witness is able to do it.

The Court: The witness can bear that in mind in answering the question.

The Witness: I am asked to designate between the two different periods? It would be hard to do and I could not answer that definitely because I have not made any recap. of that condition.

The Court:

Q. Have you noticed any difference since the petition for reorganization was filed? Have you noticed any falling off of receipts from persons who are continuing to pay?

A. Well, there has been a gradual decrease in the continuation of payments.

Q. Well, has it been a gradual decrease since the receivers were appointed, or was there any noticeable difference in the rate of decrease after the petition for reorganization [fol. 168] was filed?

A. Well, as to the payments actually made I can't answer that question because I am not familiar with the exact figures as shown by the books on that particular question.

Mr. Palmer:

Q. Who would be able to answer that question as to the amounts paid in by the contract holders between April 11 and June 6, and June 6 and the present time?

A. That could be determined by our auditor from the records.

Mr. Fleming: I think we have the auditor here and he will probably be able to answer that.

Q. Mr. McNulty, do you think you have sufficient knowledge of the affairs of this company to give any opinion upon the question of reorganization or rehabilitation of the affairs of the company?

A. Yes, sir; I feel that I do.

Q. Would you give that to the Court, please?

A. Well, I feel that a reorganization is the only way to work to the best advantage and benefit of the contract holders. I certainly don't think that a liquidation would do anything other than result in losses to the contract holders.

The Court:

Q. Now, Mr. McNulty, give the Court your basis of feeling [fols. 169-175] that, if you do feel so, a reorganization is feasible in this case.

A. Well, the only basis that—the one basis that I make that assumption on is from the general tone of the correspondence that I have seen with the contract holders. By that I mean there have been very few letters that I have seen that have been caustic or critical.

Q. Do I understand from what you say now you feel that the determination of whether a reorganization is possible or feasible or not depends on the attitude of the holders of the contracts, and that if their attitude is favorable to a reorganization then a reorganization can be effected; is that your idea?

A. Yes, sir.

Q. Then if their attitude was against reorganization, in large numbers, that would mean that it was not very likely reorganization could be had?

A. That is the way I feel.

[fol. 176] Q. Isn't it true that you were asked in that meeting by those men there present to become a member of the board of directors for the purpose of forming a quorum?

A. I was.

Q. And isn't it a fact that you refused to do so?

A. Yes, sir.

Q. And isn't it a fact that there was discussion concerning you and whether or not you should join in with the then purposes of the meeting, and that you then said, "If I am not wanted I will resign as Secretary of the corporation," or words to that effect?

A. Well, there was a discussion, general discussion, and I offered to resign as Secretary, and I did submit my resignation.

Q. And those present gladly accepted your resignation?

A. Well, they accepted it; I could not say how gladly.

Q. I will withdraw the word "gladly." Now, at the meeting when it was found there was not a quorum present, isn't it a fact that Mr. Fleming suggested that you be elected a director?

A. I think that the suggestion was made by Mr. Fleming.

Q. This same Mr. Fleming who is now appearing here as counsel for the debtor?

[fol. 177] A. Yes, sir.

Q. Isn't it further a fact Mr. John Marshall stated it would be agreeable to him but he felt there should be an attorney elected to the board?

A. Yes, sir.

Q. At the end of that meeting of the board of directors, isn't it true that after you refused to serve as a member of the board of directors Mr. Fleming said that while he did not desire to become a member of the board, in the light of future matters, since an emergency confronted them he would consent to serve on the board during the period of that meeting and would resign at the end of that meeting, and did resign at the end of that meeting of the board of directors?

A. Well, as I recall it, that is generally my recollection of what happened.

Q. In substance what I have asked you is correct, is that right?

A. Yes, according to my recollection.

Q. Now, in fairness to Mr. Fleming, it is true, is it not, that this meeting was called by the other members of the board of directors there present and not by Mr. Fleming?

A. Well, I can't answer that question. I don't know who [fol. 178] called the meeting.

Q. Was Mr. Fleming thereupon elected to the board of directors?

A. Yes, sir.

Mr. Reinhardt: May I ask the witness whether he was present at the meeting at the time Mr. Fleming was elected?

Mr. Palmer:

Q. Were you present at the meeting at the time Mr. Fleming was elected?

A. Yes, I was.

Q. Now, do you know whether at the end of that meeting Mr. Fleming did resign immediately from the board of directors?

A. No, I can't answer that; I don't know.

Q. Do you know whether the purported minutes of that meeting as taken by the secretary who acted after you resigned show that Mr. Fleming did resign at the end of that meeting?

A. I do not know. I cannot answer that.

Mr. Palmer: May we have those minutes to see whether they so state?

Mr. Fleming: Yes. I did resign.

Mr. Palmer: And that is reflected in those minutes?

Mr. Fleming: Yes.

[fol. 179] Mr. Palmer: You resigned at the end of that meeting?

Mr. Fleming: Yes.

Mr. Palmer:

Q. The election of Mr. Fleming was by the board of directors to fill a vacancy existing in the board of directors; is that correct?

A. Yes, sir.

Q. May I ask you whether or not at the time of that election and serving of Mr. Fleming he was a stockholder of Fidelity Assurance Association?

A. Not according to the records, no, he was not a stockholder.

Mr. Palmer: Mr. Fleming, may we agree at that time you were not a stockholder of record of the company?

Mr. Fleming: Oh, I don't know. If I was a stockholder it was purely for the purpose of serving as a director.

Mr. Palmer: You were not a stockholder of record as of that time?

Mr. Fleming: No.

Mr. Palmer: And any stock you may have held was given you at that time for the purpose of qualifying as a director of that meeting?

Mr. Fleming: Yes, that is right.

Mr. Palmer: Did they actually give you any, or was just [fol. 180] a promise made that you would have certain stock during the time you were elected and then at the end of that meeting that was forgotten?

Mr. Fleming: No, I was not delivered any certificate.

* * * * * * *

[fol. 181] Q. Were there any other persons present than those you have named: yourself, Mr. Fleming and the six directors?

[fols. 182-186] A. No, sir.

Q. How many other directors were there of Fidelity at that time who were actually qualified and serving?

A. There were just two.

Q. Who were they?

A. F. S. Risley and D A. Burt.

Q. Did either of them come to or attend that meeting?

A. No, sir.

Q. Did they agree, to your knowledge, to the holding of the meeting in Pittsburgh?

A. No, sir—I don't just understand.

Q. Do you know whether or not Mr. Risley and Mr. D. A. Burt agreed that it was all right with them to hold the meeting of the board of directors in Pittsburgh?

A. No, I don't know.

Q. Both Mr. Risley and Mr. Burt, as well as Mr. King, were then residents of the City of Wheeling, the home office of the Fidelity company, as well as yourself; is that right?

A. Mr. Risley was not living in Wheeling at that time.

Q. He was not?

A. No.

Q. Mr. D. A. Burt was?

A. Yes, sir.

. . . . . .

[fol. 187] Q. And it is further true, is it not, that up until that meeting of June 3 Mr. Fleming had no connection with the company?

A. No, sir; not to my knowledge.

Q. And you were Secretary of Fidelity?

A. Yes, sir.

Q. Now, is it not further true that, as was asked here earlier today, some two years ago approximately there was a plan advocated whereby one Mr. Messick and associates would buy certain stock or invest certain money in the [fol. 188] capital structure of Fidelity?

A. Well, that provided for the creation of a new company. There was no provision for money to be put directly into Fidelity.

Q. Well, my question is only leading up to a further question, in that in pursuance of this plan whereby there was to be, if possible, worked out between Mr. Messick and the stockholders of Fidelity certain agreements, Mr. John Marshall became the voting trustee of a large majority of all the stock; is that correct?

A. Yes, sir.

Q. And that plan called for Mr. Marshall to be more or less a one man committee having all the rights of the majority stockholders?

Mr. T. C. Townsend: Objection.

Mr. Palmer: This is only the background leading to the further part.

Mr. T. C. Townsend: I don't see much use in putting the answers in his mouth.

Mr. Palmer: It is cross-examination.

The Court: The objection is overruled. (Exception.)

A. Under that trust agreement he had the right to vote that stock.

[fol. 189] Mr. Palmer: I don't want to go too deeply into this, if the Court please, but I want it as background for further questions, and that is the only purpose of it.

The Court: All right, proceed.

Mr. Palmer:

Q. That plan called, in substance, for Mr. Messick and associates to invest either in a new company, as you have stated, or to advance to the Fidelity in some form approximately half a million dollars; is that right?

A. Yes.

Q. And that plan fell through?

A. Yes, sir.

Q. And Mr. Messick's connection with the company started at that time; is that right?

A. Yes, sir; approximately at the same time.

Q. And he then after that plan fell through became chairman of the board of Fidelity, did he not?

A. Yes.

Q. And did not invest a nickel in the company; isn't that right?

A. Not to my knowledge.

Q. He is and was the owner of only one share of stock; isn't that right?

A. I think that is what the record shows.

[fol. 190] Q. And can you tell us whether or not Mr. Fleming's entire connection with the company has been through his relationship with Mr. Messick?

A. Well, I am not familiar with that. I can't answer that question.

Q. And is it not true further that Mr. Messick, after he became chairman of the board of Fidelity, drew a salary of $1,000 a month?

A. For a period he did, yes, sir.

Q. And that period of time extended until Mr. Sims, the Auditor of West Virginia, demanded that that salary cease?

A. Yes.

Q. Now, during that period of time that Mr. Messick drew that money how many days a week did he spend in the City of Wheeling on the business of Fidelity, if you know?

Mr. Fleming: The debtor objects to this. It is not relevant nor cross-examination.

The Court: Overruled. (Exception.)

Mr. Palmer: Answer the question.

A. Well, he was down occasionally for a day or two.

Q. That would be one day or two out of a week, or out of a month?

A. Well, no set period. I can't be definite on that.

[fol. 191] Q. Did he spend more than three days per month on the business of Fidelity in the City of Wheeling at its home office where you were located and were secretary of the company?

A. I can't answer that definitely.

Q. To the best of your knowledge?

A. Why, I would say that he spent probably three days.

Q. Per month?

A. Yes, sir; might have been more than that. I can't answer that definitely.

Q. Now, can you tell me whether or not in the summer of 1938, when the Securities and Exchange Commission filed a civil action against the debtor in the United States District Court for the Eastern District of Michigan, Southern Division, the six directors, with the exception of Mr. Messick, were not also directors of the debtor or officers of the debtor at that time?

A. With the exception of Mr. Pulfer—he was connected with the company but I don't recall exactly whether he was an officer or director at that time.

Q. He was an employee of the company at that time, was he not?

A. Yes.

Q. Do you know whether you and the other officers and [fols. 192-195] directors during this year filed with the Securities and Exchange Commission an application for exemption from ineligibility imposed by Section 9a of the Investment Company Act of 1940 whereby, by reason of the decree entered in the federal court in Michigan the officers and directors, including those six, with the exception of Mr. Messick, were ineligible to serve Fidelity by virtue of the Investment Company Act?

A. Well, I filed the application for exemption.

Q. Did the others?

A. I think they all did, yes, sir.

Q. And isn't it true that a temporary exemption was granted, which was very shortly after that revoked?

A. I don't know whether exemption was granted or not. I know that I did see a release wherein it said temporary exemption was granted, and in a day or two release was made that that was in error.

Q. Release was what?

A. That the former release was in error, and that the temporary exemption had not been granted.

Q. And therefore at the time of this meeting there had been no exemption granted to these officers and directors, including yourself, by the Securities and Exchange Commission to act as such, had there?

A. Not to my knowledge.

. . . . . .

[fol. 196] Q. Now, Mr. McNulty, you were speaking this afternoon concerning letters which you had received from various contract holders; is that correct?

A. Yes.

Q. Was there a single one of those letters which stated that that contract holder was willing that his amount should be reduced to make new capital money available for the [fol. 197] stockholders and directors of the corporation?

A. No, sir.

. . . . . .

[fol. 198] Q. Now, Mr. McNulty, with reference to the letters you received, did the majority of those letters express a desire that the corporation be reorganized and continued in existence, did the majority express the desire that the corporation continue in existence and thereby in time wind up its affairs, or did the majority, if such existed, ask for their money and immediate liquidation of all the assets?

A. Well, that would have to be answered more or less generally because there was no specific interpretation or request, such as you put it, because we have got all kinds of suggestions as to what they think they would like to have happen. We have requests for their cash surrender values; in other cases they have elected to discontinue their pay-

ments until some plan is effected and worked out. It is just a various, large number of different expressions on the part of the contract holders.

Q. I think the Court, and I know counsel, would be interested in whether or not those letters expressed anything in the way that you can relate to us in proportions, even rough proportions, as to the desires of those writing as to whether they wanted their money immediately, whether they wanted [fol. 199] the company to go ahead and slowly wind up its affairs in the natural course of events, or whether they would like to see the company continue on in the same line of business, and if you could give us, not your ideas but your best recollection as to what those letters expressed, I believe the Court and attorneys would find it very helpful.

A. I would hesitate to answer that question because, as I said, there were so many of them that I did not determine or made no effort to determine what percentage.

Q. Would it be fair to say then that the question is one you cannot answer specifically enough to give us any aid?

A. I would say, yes, that is right.

Q. Mr. McNulty, can you give us an idea on this—by an idea I mean your best recollection—Can you tell us what percentage of those letters wanted cash immediately; to get out of the thing immediately; and what percentage wanted something else other than cash immediately?

A. I would hesitate to answer that because I could not say whether it would be 40% or 50%. It is very difficult to give any definite answer on that.

Q. Could you tell us whether there were more letters which expressed a desire for cash immediately than any other plan, or vice versa?

[fol. 200] A. No.

Q. You are unable to answer that question?

A. Yes, because I would not want to make a statement on that for I have not gone into that part of it sufficiently enough.

Mr. Fleming: If the Court please, I understand Mr. Palmer is representing Mr. Sims and the State Receivers; is that right?

Mr Palmer: Yes, sir.

Mr. Fleming: I understand that Mr. Sims and the State Receivers, particularly Mr. Smith, are anxious to bring about reorganization. I was just wondering at your attitude, Mr. Palmer, under the circumstances. I may be mistaken about

that. It seems that Mr. Lauritzen, who is fighting to liquidate apparently the assets in his state purely for the benefit of the contract holders in his state—and I am not criticizing him for that purpose—but it occurs to me there are other people interested in this company outside of, you might say, these two or three states that have this large amount of assets in their possession which they are seeking to liquidate virtually without thought or consideration for the remainder of the contract holders.

Mr. Palmer: If I may be permitted to answer that, the [fol. 201] last questions I asked were at the suggestion of one of counsel for the SEC, and the entire line of questioning was in furtherance of the questions started by you this afternoon, to which I agreed with you and the Court was a proper line of questioning to aid the Court in a determination of the wishes of the contract holders, and in attempting to question the witness here by leading questions on cross-examination I only hoped I might be able to develop the subject a little further than you had been able to do this afternoon.

The Court: The questions seem to be all right but we are not getting very much in the way of answers.

Mr. Palmer:

Q. Mr. McNulty, you stated this afternoon that when the payments of money came in on any particular series of contracts that on your books that money was credited to that series of contracts; is that correct?

A. Yes.

Q. And that thereafter when securities were bought those securities were credited on your books to that particular contract series reserve; is that correct?

A. Yes.

Q. Is it not true, however, that when you sent those securities purchased in that manner to the various states, that they were co-mingled and in a general deposit fund and not [fol. 202] earmarked specifically to any one series?

A. On our records they still remained earmarked for that particular series.

Q. But I am talking about what was done with them by the depository in the state to which they were sent.

Q. Well, I could not answer that question; that depended on the state.

(Question read to the witness.)

The Court: He says he doesn't know.

The Witness: No, your Honor, those securities, as far as our records are concerned, are still earmarked for that particular fund, but when they get to the state depository or whoever has control in the state, whether they co-mingle them or intermingle them, I can't answer that.

Mr. Palmer:

Q. Did you ever inform the state with which you made the deposit that that was to be earmarked for an individual fund and to be held for only such fund, and did you do that with each deposit that you made?

A. I think in recent years that was done, yes.

Q. How about in earlier years?

A. Well, I don't think it was done prior to 1938.

Q. Did you make the deposits with the various states so that you would know the answer to that question?

[fol. 203] A. No, the securities were not handled by me at all; I had nothing to do with that.

Q. Who did that?

A. I imagine Mr. Young, our investment man.

Mr. Palmer: It has been suggested that, the witness not being familiar with that subject, his answers to this should probably be stricken and the questions properly asked of a witness who does know.

The Court: Well, I did not understand him to say he did not know anything about it at all. He just said he was not the one who did it. You may proceed further and if you find he knows nothing about it we will strike his answers.

Mr. Palmer:

Q. Do you know of your own knowledge whether you or someone else in sending the deposits to the various states had each deposit earmarked as being reserved for a particular fund in that state?

A. Well, I believe when the securities were sent out, as I said, after possibly 1939, they were so indicated in the letter of transmittal from Mr. Young. Now, I am not certain on that but as I recall that is the way it was handled.

Q. Can you give us the answer to this, and if not tell us so: whether or not the company borrowed from one fund and put it into another fund; in other words, taking reserves [fol. 204] from Series A in one state and putting it in Series B, and so forth?

A. If that was done as far as the state deposits were concerned?

Q. Yes.

A. No, I cannot answer that definitely.

Q. Can you answer whether it was done on the books of your company?

A. No, I don't think it was done on the books.

Q. Would it be possible for you to answer that? I mean, would you be in position to know the answer to that question correctly or not, or is that just an opinion you have given?

A. As I understand your question, that the deposits as shown by our records belonged to one fund, or the securities belonged to one fund, and were they just taken and transferred to another fund?

Q. No, were they borrowed by one fund from another fund, is the question?

The Court: As I understand, the question is whether on the books of the company there were any loans made from one fund to the other?

Mr. Palmer: That is correct, your Honor.

A. Well, there was indirectly—I wouldn't term it a loan [fol. 205] in that it was an actual transfer. There was an inter-fund loan shown by the books.

Mr. Palmer:

Q. You say there was?

A. Yes, sir.

Q. And was that a frequent practice of the company to make loans, as shown by its books, of the reserves of one fund to another fund when that fund needed it to improve its financial position?

A. Well, prior to 1938 that situaton did exist in that it was created through what we term an overdraft on our books in the bank accounts of the various contract funds.

Q. That was done up until the injunction that was consented to in the SEC suit in Detroit, is that correct?

A. I think several months preceding that time.

Q. Now, Mr. McNulty, this afternoon I was asking you about the investment improvement rate, and if the Court will permit me I would like to make that a little more clear. Is it not a fact that your contract provided that you would return to the policyholder a certain amount of money, a

definite amount, in a certain number of years provided he paid in a certain amount of money per month?

A. Yes, sir.

Q. And did it not further provide that out of the money [fol. 206] he paid in you would set aside a certain part of that which, at a given rate, for instance in the special series, Special Income 5%, would amount to that figure that you were to pay him in the given number of years?

A. Yes, sir.

Q. So that using figures for example, which will not of course make it true, if you agreed to pay him $1,000 at the end of ten and a half years, and he agreed to pay you $10 a month, if your company took $8 per month of that and set it aside, at 5% interest that $8 would amount to $1,000 in ten years. That is what you were doing; is that right?

A. Well, it would be the accumulated reserve, of course, which would give consideration to compound interest on that; yes, sir.

Q. And the same would hold true if the payment were $20 and $8 would be sufficient to meet, at 5% compounded, the final payment; that was all you would have to set aside?

A. That was all that was required by the contract, yes.

Q. And the rest the company had with the exception of the maturity and reserve agreement, which was something else; is that right?

A. That is right.

The Court: Does that mean that the higher the rate of [fol. 207] interest the smaller the amount necessary to be set aside?

Mr. Palmer: Exactly, if the Court please.

Q. So that when the Investment Company Act of 1940 was passed saying that your improvement—your reserve improvement rate could not exceed 3½%, the company did not have sufficient additional assets to set up to meet the requirements so they could make payments; isn't that right?

Mr. Jaegerman: I object to that, your Honor. That is again a legal conclusion. I think they are in error. That applies only to new certificates that might be sold and not to the past business present on the books of the association.

The Court: I will confess it is not very clear to me what it means, but if it is a legal proposition let us have it in the brief rather than in the testimony.

Mr. Palmer: Your Honor, I think, is correct. I thought perhaps the witness could answer as to whether they had sufficient amount of money or securities to meet the requirements of the Investment Company Act of 1940.

The Witness: Well, I can't answer that, in view of Mr. Jaegerman's answer to that question.

Mr. Palmer:

Q. Now, Mr. McNulty, isn't it a fact that the actual yield per dollar the contract holder got on, say, Series B insurance contracts was only 1.55% return on his money?

[fols. 208-212] A. I don't recall the exact amount. It was contained in the booklet but I don't recall the exact figure, and it would depend on the manner of settlement that the contract holder would take.

Q. And isn't it true that if he went through to maturity—I am speaking now of the plan without insurance—the yield to the investor was only 2.56%?

A. Well, I can't answer that as to the accuracy; I think that is approximately correct.

Q. And 1.55 is approximately correct on the Series B where the insurance feature was part of it; is that not approximately right?

A. Well, I can't say, I don't recall whether that is the figure or not. I would say if is approximately correct.

The Court: It would be 1.56 plus the insurance benefit?

Mr. Palmer: No, your Honor, it is 1.56 if the plan went through to maturity whereby they had paid to carry the insurance but the insurance was not needed.

The Court: That is what I am speaking of; but he has had protection during that time of an insurance policy which, if he died, would pay up his contract.

Mr. Palmer: That is right, your Honor.

. . . . . .

[fol. 213] Q. Isn't it a fact, Mr. McNulty, that after the Series B contracts were issued with the insurance feature a large number of your policyholders converted their policies into such type of policy or contract?

A. Well, I don't know what percentage converted their contracts. I know that a number of them did convert the [fols. 214-215] Series B—converted their contracts to the Series B with the insurance.

Q. And it was a large number, was it not, a substantial number?

A. I would say a substantial amount.

Q. Now, you told the Court you had your own opinion, which was partially arrived at from reading letters of the contract holders, that reorganization was the only way that was to the best advantage of the contract holders; is that correct?

A. Well, I did not mean that answer in that I formed that opinion from reading those letters. That is my own personal opinion I formed myself.

Q. And will you state it again, as to what you believe is to the best advantage or for the best advantage of the contract holders?

A. I think a reorganization, definitely.

. . . . . .

[fol. 216] Q. Mr. McNulty, what type plan with reference to capital structure do you have in mind as being a proper or fit one for reorganization?

The Court: All right, you may answer the question.

A. I would say that there is a capital structure with the present company—that there should be additional and new money.

Mr. Palmer:

Q. And you would be opposed to any plan which would take any of the present assets and form a capital structure from those; is that correct?

A. To the detriment of the contractholders, absolutely.

Q. You are not in favor of an immediate or forced liquidation?

A. No, sir.

Q. Are you in favor of a plan whereby the company winds up self-liquidating; that is, the parties who are now contractholders continue to pay in until the end of their terms and the company pays out until the matter winds itself up by virtue of all contracts having ceased to exist?

A. Well, I can't answer that because I have not given [fol. 217] it sufficient study, any particular plan or the best plan.

Q. You would figure that, however, over a forced immediate liquidation?

A. Yes, sir.

Q. And you have not formulated in your mind or otherwise any particular plan other than if there is a reorganization, which you desire to see, there must be new money put in for a capital structure, by someone?

A. Yes, or if some mutual arrangement—I don't know whether that is possible, the legality of it or not.

Q. Mutual arrangement by the contract holders whereby they run the company for the benefit of themselves, you mean; is that right?

A. Yes.

Q. What have you to say as to whether or not this company could reorganize yielding only 2.56% interest on an investor's money, when the Government is now putting out so-called baby bonds yielding 2.99%?

A. Well, in any plan of reorganization some adjustment would have to be made in interest and that would all depend on what conclusions were reached in that respect. I can't answer that now, what method or what rate of interest any reorganized or adjusted policy or contract should contain.

[fol. 218] Q. Is is you belief that a group of persons other than the present group who are and have been running it could manage it better so as to obtain a higher yield on the investor's dollar?

A. Well, that is more or less an investment problem, I don't know——

Q. With which you are not familiar?

A. I am not familiar with that.

Q. Now, Mr. McNulty, other than your own personal desires and wishes do you feel yourself qualified to pass on whether reorganization is possible or probable or likely or should be had?

A. Well, I don't know whether I could—whether I would feel I would want to answer, if that is what you mean, the responsibility——

Q. No.

A. But I think I could contribute; I think I have ideas as to that.

Q. I realize that but my question is whether or not outside of your own personal wishes in the matter you feel yourself qualified from the viewpoint of an expert to say whether there should or should not be a reorganization had in this present matter?

[fol. 219] The Court: He answered that in effect. He said he thought he could contribute to that end.

Mr. Palmer: I think that is sufficient answer then. No further cross-examination.

By Mr. Farmer:

Q. Mr. McNulty, when you were talking about a reorganization of this company, I take it from your subsequent answers that you were contemplating reorganization as an investment company and not as an insurance company?

A. No, that is wrong. As I say, I haven't anything definite; there are any number of ways possibly it could be worked out.

Q. Your mind is just open either way; is that right?

A. Yes, if it can be reorganized I think it should be.

Q. Well, if it should be reorganized as an investment company doing the same type of business that it had done up until December 31, 1940, that would be selling these face amount certificates principally payable on the installment basis, would it not?

A. Yes, sir, as a face amount certificate.

Q. And most of those payments on face amount certificates are made by the contract holders on the installment basis?

A. Yes, sir.

Q. And not just cash lump payments?

[fol. 220] A. No, I am not sure whether that act provides for a lump sum payment or not.

Q. Which act are you talking about?

A. The Investment Company Act.

Q. Well, that provides for both, doesn't it?

A. I think so.

Q. The point I am making is that most of these contracts you make, the people pay in their money on the installment basis and not a lump sum?

A. That is right.

Q. And they pay monthly over a long period of years?

A. Yes.

Q. There has already been, your petition alleges, after December 31, that is, the company did not sell any of that; isn't that right?

A. Yes.

Q. And did not engage in business?

A. No.

Q. And of course that is six months before your petition was filed?

A. Yes.

Q. When you express the opinion that reorganization was feasible did you have in mind that there was very [fol. 221] serious opposition to this jurisdiction of the Court, questions being raised as to whether the Court had jurisdiction to take hold of this old company and try to reorganize it, which might lead to protracted litigation over a period of months or even years?

A. No.

Q. Well, that would have a very important bearing in the ability of the company, if it is reorganized, to pick up and carry on with these people that had been putting their money in it when the company quit, would it not?

A. I imagine so.

Q. In other words, a man after he got "cold" six months or twelve months or eighteen months is going to be hard to get to come back in the fold, isn't that right?

A. I would say time was very essential in the matter, yes, sir.

Q. Those people who put their money in these kinds of contracts are principally people of small means, small investors, that is, and that represents their savings; isn't that right?

A. Well, not——

Q. (Interposing): And a man who is trying to lay his savings away just naturally would turn to some other [fol. 222] place to put them after the thing has been in court for six months or twelve months or eighteen months?

A. Well, I can't answer what he would do.

Q. You could not answer that?

A. Why, no.

Q. Now, if the company is reorganized as one of these face amount certificate companies, you recognized, did you not, that it would have to meet the requirements of the Federal Investment Act and get the approval of the SEC?

A. Absolutely.

Q. And in addition to that you took into consideration, did you, that the company would have to be licensed to do business by these state commissioners in all these various states where it proposed to do business?

A. First? After formulating any plan—I was talking from my own opinion and what I think would be best for the contract holders. I have not gone into any legal end of it at all.

Q. Of course, what the Court is concerned with——

A. (Interposing): But those things would all have to be considered, of course.

Q. Yes, sir; and what the Court is concerned with is whether there is any reasonable prospect of a plan, and not [fol. 223] whether you want it or whether you don't.

A. That is true.

Q. And that would be a very material consideration that would have to be determined right at the beginning, whether this company could get the permission from these insurance commissioners and securities commissioners in all these different states that have authority to license them or keep them out; whether they can get that permission to take up and carry on again, would it not?

A. Yes.

Q. Now, the petition alleges that the company at the time of the filing of this petition in bankruptcy was not licensed in any state, I believe.

A. I am not familiar with the petition; I did not see it.

Q. That is a fact, is it not?

A. We were not operating in any state December 31.

Q. Its license had been revoked in Illinois last year some time, had it not?

A. Yes.

Q. The insurance commissioner out there, and the state officials, revoked it in Illinois?

A. Yes.

[fol. 224] Q. That was a pretty big state; that is, you had sold a lot of contracts out there up to that time?

A. Yes.

Q. So that you have no facts and no information from your study of this problem that would lead you to believe that there was any prospect of getting the approval of the securities commissioners in these different states in which the company has been doing business to give it a license, have you, to carry on again?

A. No, only I believe it is my personal opinion the securities commissioners would consider anything that worked for the benefit of the contract holders, and that is the assumption I have been using.

Q. You said you had communications from several thousand contract holders. Just to get it in the record, I will ask you if you sent out this letter dated July 3, 1941, from the Central Trust Company as one of the communications to contract holders (handing letter to witness).

The Court: Is that a letter from the Central Trust Company?

Mr. Farmer: Yes, sir.

The Court: This man did not send it out, did he?

A. No; it was sent out.

[fol. 225] Mr. Farmer: They undertake to tell the Court about the sentiments of these contract holders, and I wanted to show what type of communications may have been influencing those sentiments, and he said this went out to them, he has identified it in that way, and I would like permission to make it a part of the record and file it as an exhibit.

The Court: I suspect what you are filing there is a letter sent out by the Trustee, which was sent out by the Trustee after a conference with the Court. Is that the letter, Mr. Townsend?

Mr. T. C. Townsend: That is, your Honor.

Mr. Farmer: I am not criticizing anybody; just trying to show what these contract holders got.

The Court: I don't see where you are getting anywhere with this sort of examination, and if we are going ahead at this rate we will be here next week still cross-examining this witness; and I want to get through with him and get out whatever pertinent information you can, but refrain from going into all these matters that don't have anything to do with the issue here.

The Farmer: Does the Court rule I cannot file that letter?

The Court: You may file it.

[fols. 226-227] Mr. T. C. Townsend: It is already in the record but if you want it in again, all right.

Mr. Farmer: I did not know it was in.

Mr. T. C. Townsend: It went out from the Trustee with the permission of the Court.

Mr. Farmer: All right, let it be marked filed as Tennessee Exhibit No. 1.

Tennessee Exhibit No. 1, Filed.

* * * * * * *

[fol. 228] Mr. Farmer:

Q. Now, Mr. McNulty, did you send a certification to the Insurance Commissioner of Tennessee about the amount of the liabilities of that company in Tennessee, to holders of contracts sold in Tennessee, with relation to the deposit of securities in Tennessee?

A. You mean, recently?

Q. No, at any time.

A. Well, it has been done formerly, from time to time. I don't recall the last date.

Q. Did you send it yourself, certify to it yourself?

A. I think I did.

Q. You certified it in September, 1940, did you not?

A. I don't recall the date.

Q. You just certified the liabilities in a lump sum without making any division between Series A, B, C, and D?

A. I don't recall the form now that was sent out.

Q. You don't recall that you did ever send any certification to Tennessee dividing them up into classes like that, do you?

A. Oh, yes.

Q. To Tennessee?

A. Yes.

Q. When?

[fol. 229] A. I think the certification to Tennessee always was broken down as to contract funds, the liability in each fund.

Q. You did that to the Insurance Commissioner of Tennessee?

A. That was my impression, that it was furnished that way, yes.

Q. But you cannot say when that was done?

A. No, but the last one I would say that was sent out.

Q. Was that September of 1940?

A. I don't recall.

Q. Did you ever do that in case of Maryland?

A. I think Maryland was furnished a certification of the liability, yes, by funds.

Q. By series?

A. I think since 1938 they have all—all reports have been shown by funds, by series.

Q. Could you make a search by tomorrow morning and if you can find any such report or certification made by the

company to any of these states dividing up the liabilities into series, produce that?

A. I can't produce it by tomorrow morning. That would be in the records in Wheeling.

The Court: Do you have information it was not done, Mr. [fols. 230-231] Farmer?

Mr. Farmer: All I know, I saw the certification in September, 1940, to the Insurance Commissioner of Tennessee and my recollection is that it is just a lump sum; just said liabilities so much.

Mr. Lauritzen: If the Court please, we have that same information in Wisconsin, up to the last time they made it in Wisconsin they had never, on any occasion, stated where those securities came from or whether they came out of any particular fund or otherwise. It just came out there as a lump sum to be deposited under our laws.

. . . . . .

[fol. 232] Q. There would be no way you know of to make up that deficit unless somebody either put new money in the company or unless you took something away from the class where there was not a deficiency or where there was a small deficiency, trying to equalize it among the others, would there?

A. I have not gone into the point of developing any plan.

. . . . . .

[fols. 233-234] Mr. Farmer:

Q. Mr. McNulty, let me ask you this: you are a stockholder in the company?

A. Yes, sir.

Q. You have how many shares of stock?

A. Thirty-five shares.

Q. And you have been with the company since 1922?

A. Yes, sir.

Q. And you feel attached and devoted to the company?

A. Absolutely.

Q. And you just hope there is some way to reorganize?

A. That is right, yes, sir.

. . . . . .

[fol. 235] By Mr. Lauritzen:

Q. Mr. McNulty, this afternoon you testified that from 1913 to 1935 the sales of the Fidelity contracts were handled by an organization known as the National Sales Agency.

A. Yes; and the firm of Irving & Sisson, for a part of that time, had the right to sell in the Western territory.

Q. Who owned the National Sales Agency?

A. Well, it was, as far as I know, owned by Fred M. [fol. 236] King, A. L. King and I think three or four other stockholders.

Q. Is that the same A. L. King presently a director of Fidelity, or was within recent months?

A. Yes, sir.

Q. Do I understand that company took charge on its own account, hired its own salesmen and conducted the complete sales campaign all over the country during those years?

A. They handled the sales exclusively.

Q. With that other company in part?

A. Yes.

Q. And Fidelity during those years had no salesmen of its own?

A. No.

Q. In 1935 you made a change?

A. It was 1934 or 1935, I am not sure.

Q. And did Fidelity then take on its own salesmen?

A. They were hired by the agency division which was granted for the purpose of operating the National Sales Agency.

Q. Did that company continue to exist as a company?

A. Yes, it continued to exist as a company, I think.

Mr. Palmer: There was a contract between the National Sales Agency and Fidelity Investment Company whereby [fol. 237] National Sales Agency would sell the contracts and receive a certain commission from Fidelity. In order to build up its sales force it borrowed in advance certain money from Fidelity for the purpose of building up its sales force. In time that liability became close to the million-dollar mark, and Mr. Fred M. King, the leading figure of it individually, went into bankruptcy and the National Sales Agency owed Fidelity approximately $1,000,000. In order to liquidate that debt Fidelity kept the National Sales Agency as a going concern and had it hire salesmen and

all the profits made by National Sales Agency went to reduce the deficit owed by National Sales to Fidelity. However, other than having an organized sales company which, of course, is of value to any company, National Sales had no other assets but did have the deficits. Is that substantially correct, Mr. McNulty?

A. That is substantially correct. The agency division operated the National Sales Agency.

Q. After the deficit was discovered?

A. Yes.

The Court: The Fidelity was paying off the debt with its own money?

Mr. Palmer: That was substantially what happened.

The Court: All right.

[fol. 238] Mr. Lauritzen: Mr. McNulty, do I understand then, with the background of Mr. Palmer's statement, that the sales policy of the company after 1935, and up to the time when they went out of business, was determined and originated with the officers of Fidelity?

A. I would say that is substantially right.

Q. Did you have district managers?

A. Yes, sir.

Q. By states?

A. No, by territory. First we had branch office managers, then we had what we called supervisors.

Q. And they got their directions from the home office?

A. From the director of the sales organization, yes.

Q. Who was that?

A. Well, at that particular period it was Carrol D. Evans.

Q. Mr. McNulty, are you familiar with the fact that in the State of Wisconsin, and in numerous other states where Fidelity had a deposit, the sales force of Fidelity was instructed to stress that point in connection with their sales efforts in those states as a representation to prospective buyers that they were fully protected by having a deposit in that state, as to the liability which the company would [fol. 239] incur on the contracts?

A. I was not familiar with the sales policy.

Q. You have no information on that?

A. No, sir; I can't answer that.

Q. Who could give us information on that?

A. Well, I imagine the head of the sales department at that time.

Q. Who was the head of the sales department in December, 1940?

A. Mr. F. H. Pulfer. What date did you say?

Q. December, 1940.

A. Yes, he was the one.

Q. And he had been in that position how long?

A. I think since April of 1940.

Q. Will you tell us who was there before him?

A. Carrol D. Evans.

Q. Where is Mr. Evans now?

A. I think he is located in Wheeling, but he is not with the company any more.

Q. But Mr. Pulfer is?

A. Yes, sir. Well, he is still a director of the company.

Mr. Fleming: I might say Mr. Pulfer is here and will [fol. 240] be a witness for the debtor.

Mr. Lauritzen:

Q. Mr. McNulty, what happened to the sales force of Fidelity in December, 1940, when they ceased selling contracts all over the country, do you know?

A. Well, only from observation, that is all.

Q. Could you give us a general picture of that?

A. Naturally, there was—in December, 1940?

Q. Yes.

A. Well, I think they have just gradually left the company and become associated with other companies.

Q. Now, if this company were to be reorganized and go on in any business of the nature in which it has been engaged during its lifetime, they would have to get a new sales force, that is obvious, is it not?

A. Yes.

Q. In connection with your statement you thought reorganization was in the best interest of depositors, or contract holders rather, have you given any consideration to how long it would take now to build up a new sales force for Fidelity?

A. No, but I would say this, that there would be enough of those salesmen who were interested in the contract holders they sold that if there was a chance to work something [fol. 241] out to their benefit they would come back and represent the company.

Q. You mean, represent them in selling new contracts to new people?

A. Well, or in any capacity that would help the contract holders they had sold. I think they have enough faith in the company to do that.

Q. You mean they might come back and give them information of that sort?

A. No, I think they could be rehired.

Q. And run the business in the same manner as they did before?

A. Well, did I say that? I didn't say that.

Q. You have not given any consideration to this?

A. That is just my personal observation that those men could be obtained, if necessary.

Q. Mr. McNulty, do you know what has been done since the company ceased selling in December, 1940, with respect to the branch offices maintained in various cities in the country?

A. Well, they have been closed.

Q. And what has happened to the equipment in those offices?

[fols. 242-247] A. Well, in some cases I think it was placed in storage; then in other cases I think recently it has been shipped to Wheeling for storage. I don't know whether any of it has been sold or not.

Q. I take it to operate any sort of company such as you had, you would have to secure new leases and open up new offices in a similar manner as the offices existed prior to the time when you ceased selling?

A. I would not say similar, no, sir. I don't think it would be necessary to go to that extent in the branch offices.

Q. You think you could have a less number of offices or something of that sort?

A. Less expensive offices; yes, sir.

* * * * * * *

[fol. 248] Q. In how many states was Fidelity Investment Association qualified to sell its face amount certificates?

A. At any given date?

Q. During the period when you were assistant secretary and later secretary and vice president.

A. I would say some eighteen or nineteen.

Q. At one time you sold in twenty-nine states, did you [fol. 249] not?

A. I think we were licensed in twenty-nine states.

Q. And the business outstanding on the books of Fidelity Investment Association is a face amount certificate business outstanding in some twenty-nine states in the United States?

A. Yes.

Q. And fifteen of those states required deposit of securities; isn't that right?

A. I think that is right.

Q. And the other states did not require a deposit?

A. No.

Q. And for the states that did not require a deposit, a deposit was made in the State of West Virginia?

A. Yes, sir.

Q. With the State Treasurer of West Virginia.

A. Yes, sir.

Q. Now, Mr. McNulty, with what department in these twenty-nine states, where Fidelity Investment Association sold their face amount certificates, did you qualify?

A. Well, in various departments; in some states it was the insurance department, and some the banking commission; others under the securities departments.

[fol. 250] Q. So that the record may be clear, let us go down the list state by state. You sold certificates in Alabama, did you not?

A. Yes.

Q. With what department did you qualify in Alabama?

A. The Securities Commission.

Q. With the Alabama Securities Commission and more particularly the securities registrar, did you not?

A. Well, it was with the Securities Commission; I don't know the title.

Q. Did Alabama require a deposit of securities?

A. Yes.

Q. Do you remember the deposit liability?

A. No, I don't.

Q. I mean requirements. Was not the deposit required to cover the liability to certificate holders in Alabama?

A. Yes.

Q. Certain securities were eligible for deposit; isn't that right?

A. Yes.

Q. And this deposit was made with arrangement with the Securities Commission, as no requirements for a deposit

[fol. 251] were contained in the Alabama securities law; isn't that right?

A. That is my recollection.

Q. And on October 31, 1940 you had a net cash liability of $27,962.31 to contract holders in Alabama; isn't that approximately right?

A. I think that is approximately right.

Q. And you had securities on deposit with the Alabama Securities Commission, with a quoted market value of $30,213,76; isn't that right?

A. I think that is approximately right.

Q. What securities did you sell in Alabama; the Series A, was it not?

A. No, the Series D. That is the only one we sold recently.

Q. What series did you sell prior to Series D in Alabama?

A. I think probably Series A.

Q. Now, let us go to Delaware. With what department of the State of Delaware did you qualify?

A. That was the State Banking Commissioner.

Q. The State Banking Commissioner at Dover, Delaware?

[fol. 252] A. Yes.

Q. What series certificates did you sell there?

A. My recollection is that we sold Special Income—

Q. (Interposing) Let me put it this way: What series did you sell there, and what series are presently outstanding on the books of Fidelity Investment Association, face amount contract certificates?

A. Well, my recollection is that we sold Special Income contracts, the Special Annuity Series A and Special Annuity Series B.

Q. That is right. Now, as of October 31, 1940, your net cash liability to residents of Delaware on the four series you have just mentioned was $291,560.34; is that approximately right?

A. I don't have the exact figures, but I think it is.

Mr. Palmer: It has been suggested that perhaps we could save time, if he has these amounts tabulated, and just put the whole thing into the record, in tabulated form, if the witness can agree to it, because I presume Mr. Jaegerman's figures have been checked, and it might save time to

have it in in that form, and it would probably be helpful to all of us to have it in in a tabulated form, where we could [fol. 253] all use it.

Mr. Fleming: That would be agreeable to the debtor.

The Court: It seems that you can do that. I think you could read off those, and ask the witness if that is correct.

Mr. Jaegerman: I think that would save time.

Q. Now, the quoted market value of your deposited securities in Delaware, as of the same date, was $293,731.88. The date was October 31, 1940, which was the last audited date as prepared by any competent accountant.

Mr. Huwe: Are these figures in the printed report attached to the debtor's petition?

Mr. Jaegerman: I am not familiar with what report was attached to the debtor's petition.

Mr. Fleming: The Haskins & Sells audit was attached to the petition.

Mr. Jaegerman: That is the source of my information as confirmed by various statements.

The Court: Read the whole thing and then the witness can answer as a whole, and these other parties can get their data, then, from the Haskins & Sells report.

Mr. Jaegerman:

Q. Mr. McNulty, in Illinois you sold, or the Fidelity Investment Association sold, Series A and B Income Annuity [fol. 254] contracts?

A. That is right.

Q. And you qualified with the Secretary of State of Illinois?

A. That is right.

Q. And you made a deposit with the State Treasurer of Illinois?

A. Yes.

Q. Now, to go back to Delaware: In Delaware you were required to make an initial deposit of $100,000 in market value of securities, and additional deposits were required to cover liability, and this was required by statute and not by rule or regulation?

A. Yes.

Q. In Illinois the statutes required an initial deposit of securities in amount not less than $50,000, and additional deposits were required to cover liability. The law is applicable to contracts sold since July 7, 1931 and dd not apply

pror to that date. The net cash liability to residents of Illinois, as of October 31, 1940, was $4,284,194.62, and the quoted market value of the securities as of October 31, 1940 was $3,598,632.50.

A. That liability, Mr. Jaegerman, I think that included—[fol. 255] I am not sure, but I think it was calculated there to show the liability before and after July 7, 1931; that is the total of both, I think.

Q. Yes. Now, with respect to Illinois, do you remember, Mr. McNulty, that in March, 1941, I requested you to furnish me with a breakdown of the cash liability in Illinois by series, further broken down as to certificates sold prior to July 7, 1931, and after July 7, 1931, together with the market value of that deposit?

A. I recall that.

Q. Did you prepare that for me?

A. Yes.

Q. Or have it prepared under your supervision?

A. Yes.

Mr. Jaegerman: I want to offer this paper as Exhibit No. 7, your Honor.

Q. Now, Mr. McNulty, I show you what has been marked as Exhibit No. 7, and ask you if you recognize it (handing paper to witness).

Mr. Gray: May I have time to look at those figures, too?

Mr. Jaegerman: Certainly (handing paper to counsel).

A. Yes, I recognize that.

[fol. 256] EXHIBIT NO. 7 FILED

The Court: All right, we will pass on to some other state in which Mr. Gray is not interested, while he examines the exihibit.

Mr. Jaegerman: As a matter of fact, I furnished that information to the State of Illinois, so it is the same as in their records.

Mr. Lauritzen: Were these figures furnished to you by Fidelity?

Mr. Jaegerman: Yes. I think I have developed they were furnished at my request, and prepared under this witness' supervision.

Mr. Lauritzen: And the values shown on there—who is it that arrived at those particular values?

Mr. Jaegerman: I will ask the witness that question.

Q. Mr. McNulty, who prepared the market value that appears on this record? Was this the market value prepared by Mr. Young, or by the State of West Virginia, or internally by the Fidelity?

A. I think that was prepared internally by the association.

Q. And how was it prepared?

A. That was taken from the market quotations of that [fol. 257] date.

Q. From market quotations as of that date, from the Wall Street Journal, Moody's——

A. (Interposing): Yes, the market quotations as of that date.

Q. Probably prepared by C. E. Smith in charge in the investment department at Wheeling, but under your supervision as vice president and secretary of Fidelity?

A. That is right.

Mr. Lauritzen: In offering these they are not offered for the purpose of establishing these values, but only to show that this was a representation that Fidelity made to you as an officer of the Securities and Exchange Commission, at your request; is that right?

Mr. Jaegerman: I offer it for any purpose. It is in evidence as proof for whatever value it may have.

Mr. Lauritzen: If you are offering it for the other purpose, I think it would be improper as being a statement of value, because we have no opportunity to cross-examine the person who made up the compilation, which necessarily must be the result of opinion in some cases, and extended research in others.

The Court: He says they are market quotations. I [fol. 258] don't know how else you can establish market value than that. I will admit it, and overrule the objection. (Exception.)

Mr. Jaegerman: I will just refer to one series, your Honor. This record speaks for itself. The cash liability on income reserve Series B, all sold after July 7, 1931, was $2,840,879.53, while the market value of the deposited securities belonging to Income Reserve Series B is $2,444,950, being approximately $400,000 in excess of liability attributable to that series, while as compared with that we have the cash liability of the Special Income contract, for example, being $160,105.25 and no deposit at all of securities belonging to the Special Income contract funds.

Q. I now refer to the State of Indiana. In Indiana the Special Income, the Special Annuity, Series A and Series B face amount installment investment certificates were issued and sold by Fidelity Investment Association.

A. Yes.

Q. With what department were you qualified in Indiana?

A. Up until, I think, approximately 1934, it was under the Auditor's jurisdiction; then we qualified with the Securities Commission.

[fol. 259] Q. Did you make a deposit in Indiana?

A. Yes, that deposit has been made there. It was one formerly maintained with the Auditor and when we first qualified under the Securities Law, there was *no deposit* required, but later, by a ruling—I think it was a ruling by the commission for a deposit.

Q. That is right. The present law does not require a deposit, but a deposit was maintained to cover liability on contract sold prior to April 1, 1935. The original deposit was $150,000, and additional deposits were required to cover liability. There is a ruling of the department, which required deposit to cover liability on contracts sold after April 1, 1939, but that is not by statute but by ruling of the Securities Commissioner of the State of Indiana.

A. That is my understanding.

Q. As of October 31, 1940, the net cash liability to residents of Indiana was $359,866.83, while the quoted market value of securities deposited in Indiana was $159,971.87. I now go to the State of Iowa. With that department are you qualified in Iowa?

A. There was a dual registration in the State of Iowa. We have not operated in that state for some time. They [fol. 260] are both under the Auditor of the State and the securities department, I think.

Q. And the Insurance Commissioner.

A. I think so.

Q. Charles R. Fisher, Commissioner of Insurance.

A. Yes.

Q. In Iowa you only sold the annuity contract; isn't that right?

A. I think that was right.

Q. And that was sold some time ago; there have been no recent sales in Iowa?

A. No, that is right.

Q. As of October 31, 1940, the Iowa net cash liability was $32,325.08, while the quoted market value of the deposit was $44,696.25, being an excess deposit?

A. Yes, sir.

Q. In Iowa there was a required statutory deposit requirement of $25,000, and then further deposit required to cover liability on all contracts sold in Iowa, and that is by statute, is it not; or is $25,000 the only statutory deposit?

A. I think the deposit we had out there was maintained just to cover the liability, but I am not sure.

[fol. 261] Q. Since your liability here was in excess of $25,000, the $25,000 would apply as initial deposit and the balance to cover excess liability above $25,000?

A. Yes, sir.

Q. I go now to the State of Kansas. In Kansas the Fidelity Investment Association sold the Special Annuity contract and the Series B face amount installment certificate contract?

A. Yes.

Q. With what department did you qualify in Kansas? It was the State Corporation Commission, was it not, the Special Assistant Commissioner?

A. That is right.

Q. As a matter of fact, it was with the Kansas Corporation Commissioner in his capacity as Securities Commissioner; isn't that right?

A. The State Corporation Commission, I think.

Q. Yes, the State Corporation Commission.

A. By the Securities Commissioner.

Q. There are several laws in Kansas, an old law requiring deposit of $50,000 of securities in good standing, and not in default, and additional deposits to cover liability; but under the new law there is no requirement for any deposit. [fol. 262] Now, in Kansas the net cash liability as of October 31, 1940 was $161,272.45, while the quoted market value of the Kansas deposit is only $82,687.50.

A. That is giving effect to the—well, the deposit was maintained there so far as the law required.

Q. Only under the old law, and not under the new law?

A. Yes.

Q. And that accounts in part for the deficiency in the deposit?

A. Yes.

Q. I refer now to the State of Kentucky. In Kentucky the Special Annuity contract was sold and the Series D contract; isn't that right?

A. Yes, I think so.

Q. And in Kentucky you qualified under the Department of Banking and Securities, and more particularly the division of securities?

A. Yes.

Q. And the statutory deposit requirements in Kentucky are $10.000 plus additional deposits to cover liability?

A. Yes.

Q. I am sorry, as a matter of fact that is not a statutory [fols. 263-265] deposit.

A. No, that is by agreement.

Q. That is required by agreement with the securities department of the State of Kentucky?

A. That is right?

Q. And there is no statutory requirement in Kentucky?

A. Not that I know of.

Q. In Kentucky the net cash liability to residents on face amount installment certificates sold by Fidelity Investment Association in Kentucky as of October 31, 1940 was $83,911.07; while the quoted market value of the deposited securities was practically the same, $83,531.25. Now, all the states that I have talked about until now, as far as the measure or the evaluation of deposits of securities were concerned, it was always market value of securities, was it not?

A. Yes, I think that is right.

Q. Whether it was by statute or agreement, the value of the securities offered for deposit was measured by market, and at subsequent periodic valuations was always measured at market; isn't that right?

A. Yes.

Q. And whether required by agreement or statute, that [fol. 266] was the requirement set by the State Securities Commissioners, Banking Commissioners, or whatever officer had charge of that deposit?

A. Yes.

Q. And you, as Assistant Secretary and later as Secretary and Vice President of Fidelity, were charged with the duty of fulfilling those requirements?

A. That is right.

Q. I go now to the State of Maryland. In Maryland, Fidelity Investment Association sold the Special Annuity

contract, Series A and Series B face amount installment certificates?

A. Yes.

Q. In Maryland with what department did you qualify?

A. The Insurance and Banking.

Q. It was both the Insurance Department and the Banking Department?

A. I think that is right.

Mr. Eney: That is not correct.

Mr. Jaegerman: According to my record there was qualification with the Insurance Commissioner and the State Insurance Department.

The Witness: That is right; it was the Insurance and [fol. 267] not the Banking Department.

Q. The Insurance and not the Banking Department?

A. Yes.

Q. In Maryland the law specifies the deposit shall be based on market values and shall be maintained to cover liability with provision that such requirement may be waived upon proof a foreign corporation is maintaining sufficient deposit with its home State. Are you familiar with that?

A. Yes.

Q. Was it waived at any time, do you know?

A. I don't remember.

Q. You don't remember whether it was waived in Maryland at any time?

A. No.

Mr. Eney: The laws says that no deposit shall be required in Maryland if a deposit of 100% of all liabilities is maintained at the home office—at the home state, I mean.

Mr. Jaegerman: Yes, that is what I said.

The Court: With that amplification, all right, let us proceed.

Mr. Jaegerman: In Maryland the net cash liability to [fol. 268] face amount investment certificate holders as of October 31, 1940 was $484,389.90, and the quoted market value of the securities deposited in Maryland as of that date was $466,268.75, which was almost compliance with the requirement. I go on now to the State of Missouri. In Missouri the Special Annuity contract and Series A and

Series B certificates, being installment face amount investment certificates, were issued and sold by Fidelity Investment Association?

A. Yes.

Q. In Missouri qualification was with the Commissioner of Securities, was it not?

A. Under the Secretary of State.

Q. Under the Secretary of State?

A. Yes, sir.

Q. Although there was no specified requirement for deposit in the securities law in Missouri, there was a deposit agreement designating a deposit in the total sum $303,000, and giving the Securities Commissioner the right to accept additional securities through his custodian, with additional deposits to be made from time to time as liability increased.

A. That is right.

[fol. 269] Q. With what department was that deposit maintained, or with what custodian?

A. The Wheeling Dollar Savings & Trust Company, Wheeling, West Virginia.

Q. Mr. McNulty, Mr. Schurr, attorney for the Securities Commissioner of the state of Missouri, informs me that for a time the deposit was maintained in Missouri, but then at the request of the Fidelity Investment Association, that deposit was transferred from Missouri to the Wheeling Dollar Savings & Trust Company at Wheeling, West Virginia. Does that fit with your recollection?

A. I don't recall whether it was originally maintained in the State of Missouri, or not; I could not say definitely. I don't recall whether it originally was deposited in Missouri, or not.

Q. Would there be any one representing the debtor who would have knowledge of that fact, that you could tell us of?

A. Well, it could be ascertained from our records, I am sure.

Q. Apparently some one from the home office?

A. Yes.

Mr. Jaegerman: Your Honor, that is all apparently in [fol. 270] the record in the petition for intervention filed by the Securities Commissioner of Missouri, so I think we can go on.

The Court: All right.

Mr. Jaegerman:

Q. In Missouri, as of October 31, 1940, the net cash liability on face amount installment certificates sold by Fidelity Investment Association in Missouri amounted to $859,451.32 as of October 31, 1940, and the quoted market value of deposited securities was $823.938.12. Now, was it not your practice, Mr. McNulty, as an officer of the Fidelity Investment Association, to furnish the State of Missouri monthly a tabulation of the cash liability and the market value of the deposit against that cash liability?

A. Yes, sir.

Q. Did not you have prepared under your supervision and furnish me some time in March, 1941, with a copy of the Fidelity Investment Association cash liability and the market value of deposit for the State of Missouri, with the Wheeling Dollar Savings & Trust Company as of February 28, 1941?

A. I don't recall.

Q. And was not this report broken down by series, and [fol. 271] furthermore by funds within the series?

A. Yes, sir, I think so.

Q. I show you what has been marked for identification Exhibit No. 8, and ask you whether that is the document or sheet you prepared for me.

A. I think that is the paper.

Mr. Jaegerman: I would like to show this to the representative of the Securities Commission of the State of Missouri, before offering it in evidence (handing paper to Mr. Schurr).

Mr. Schurr: That is all right.

Mr. Jaegerman: The representative of Missouri tells me this is correct, your Honor, and I therefore offer this paper in evidence as Exhibit No. 8.

The Court: All right.

Exhibit No. 8 filed.

Mr. Jaegerman:

Q. Mr. McNulty, referring to Exhibit No. 8, I will refer to just one or two items: the Income Reserve Series A had a cash liability of $55,770.99 as of February 28, 1941, but the market value of deposited securities belonging and allo-

cated to Income Reserve Series A was $119,768.13, while Special Annuity contract had a cash liability of $291,364.42 [fol. 272] with market value of the deposit only $203,060, being a deposit deficiency of approximately $90,000.

I will now proceed to the State of Ohio. In Ohio the Fidelity Investment Association sold the Special Annuity contract, Series A contract and Series D face amount installment investment certificates, which were issued by it. In Ohio, according to my record, qualification was with the Superintendent of Insurance, and deposit was with the Treasurer of the State of Ohio, but there were various intermediate liabilities and I would like to call upon Mr. Dale Dunifon to state that in the record at this time, as he is familiar with it.

Mr. Dunifon: May it please the Court, there was a qualifying deposit of $100,000, put up with the Treasurer of the State of Ohio, and then a deposit was put up with either the Securities Department or the Insurance Department, I am not sure which, at the time the law requiring an additional deposit was made. At the present time that deposit is held by the Superintendent of Insurance, who by virtue of his office is supervisor of bond investment companies and insurance companies. Two separate deposits were made at different times complying with different laws.

[fol. 273] The Court: What is the situation with reference to the liability in Ohio, and the deposits and the different funds securing those liabilities?

Mr. Jaegerman: I think he has the figures on that.

So that Fidelity Investment Association was at various times qualified with the securities department in Ohio, and with the insurance department in Ohio, Mr. Dunifon?

Mr. Dunifon: Yes, sir.

The Witness: I don't think it was the securities department. I think it was the director of the bond investment companies under the Bond Investment Act.

Mr. Dunifon: If the Court please, the Director of Commerce was given authority to designate one of his assistants, either head of the building and loan department, head of the department of insurance or head of the department of banking or the head of the department of securities as Bond Investment Commissioner, and that was changed—that was changed as different Directors of Commerce came in office, you understand.

Mr. Jaegerman: So that the person or agent with whom qualification was made in the first instance was the Bond Investment Commissioner?

[fol. 274] Mr. Dunifon: That is right.

Mr. Jaegerman: In Ohio a statutory deposit of $100,000 was required. Deposit is required to cover liability on contracts sold from the effective date of the law which was April 13, 1939, but the law provides for a deposit to cover liability on all contracts sold prior to the date of the law, on or before March 1, 1940, before receiving a certificate of authority, and it was because of Fidelity Investment's failure to comply with this retroactive deposit requirement that no certificate of authority was issued after March 1, 1940, and after that date Fidelity no longer sold any certificates in the State of Ohio. However, it continued to service face amount installment certificates sold prior to March 1, 1940, and still continues under the receivership to service those certificates.

In Ohio, as of October 31, 1940, the net cash liability to face amount investment certificate holders who purchased certificates from Fidelity Investment Association, was $2,346,326.88, while the quoted market value was only $487,346.57, indicating a very substantial deficiency in the deposit, which was due to that retroactive nature of the law.

The Witness: Yes, sir.

[fol. 275] Q. Mr. McNulty, I go now to the State of Pennsylvania. In Pennsylvania Fidelity Investment Association sold Special Income, Special Annuity, Series A and Series B face amount installment investment certificates.

A. I think in some few instances also Series D contracts were sold in Pennsylvania, too.

Q. But those were—

A. (Interposing) More or less isolated sales, yes.

Q. More or less isolated sales which resulted from their proximity to Ohio, where you were selling a Series D certificate?

A. Adopted principally for Schuylkill County, Pennsylvania, on account of that insurance.

Q. In Pennsylvania you qualified with the State Securities Commission, did you not?

A. Originally it was the banking department, I believe. That law was changed and supervision was changed.

Q. At one time you qualified with the banking department in the State of Pennsylvania and subsequently and

presently with the State Securities Commissioner at Harrisburg, Pennsylvania?

A. Yes, sir.

Q. That is right, is it not?

[fol. 276] A. Yes.

Mr. Jaegerman: I see Mr. Scott is here representing the Pennsylvania Securities Commission. May I inquire if what I have said is true, Mr. Scott?

Mr. Scott: That is right.

Mr. Jaegerman:

Q. In Pennsylvania a statutory deposit of $100,000 is required by Acts of 1933, Section 7?

A. I think that is right.

Mr. Jaegerman: Your Honor, I think I should read that in evidence, because there is some peculiar wording.

The Court: All right.

Mr. Jaegerman: (Reading) "The commission may require every corporation licensed under the provisions of this act, to set apart a fund, no portion of which shall be applied to the expense of such corporation, which shall consist of not less than 10% of the amount designated in each contract issued as applicable to the payment of the expenses of conducting the business of such corporation."

Q. You are familiar with that statute, are you not?

A. I think that is right, yes.

Q. In Pennsylvania the net cash liability was the highest of any other state, was it not, Mr. McNulty?

A. I think that is right.

[fol. 277] Q. It amounted in October, 1940, on October 31st, to $4,748,886.63, while on that same date the market value of the deposit was only $229,229.38, leaving a deposit deficiency in excess of four and a half million dollars.

A. Yes.

Q. I now go to the State of Tennessee. In Tennessee Fidelity Investment Association sold the Special Annuity contract and Series B installment face amount investment certificates?

A. Yes.

Q. In Tennessee qualification is with the Department of Insurance and Banking; isn't that right?

A. Yes.

Q. And there is no statutory requirement for deposit in Tennessee, is there?

A. Not to my knowledge.

Mr. Tipton: Your Honor, that is not accurate. There was a statute passed in 1939, which requires 100%. I have the original act in my possession here.

Mr. Jaegerman: Was that statute retroactive?

Mr. Tipton: Yes, sir.

Mr. Jaegerman: If you have that statute will you offer it in evidence at this time?

[fol. 278] Mr. Tipton: I don't have it here; it is in my room in the hotel, part of a volume of acts, but I can read it into the record, if you wish.

Mr. Farmer: I have a copy here. It is pretty long, however.

Mr. Gray: While on that subject, I object to this witness giving his version of the law of Illinois. I would just as soon the Court would take judicial knowledge of our statutes. I would like to offer the securities law of Illinois, if the Court please, as an exhibit in this case.

The Court: That would probably be better, yes.

Exhibit No. 9 Filed

Mr. Palmer: If I understand, this is not an attempt by Mr. Jaegerman to expound the law of any of these states, but it is a statement of fact to which the laws of the states would be applicable as furnished to your Honor by the various attorneys under the agreement this morning.

The Court: That is true, but the more accurate they can be right here, the better.

Mr. Jaegerman: What I am offering now is not my idea of the law, your Honor, but the idea of the responsible officers of Fidelity Investment Association, their description or understanding of the law as they understood it to apply to them; and therefore I believe it is relevant.

[fol. 279] Mr. Gray: Well, we would rather the Court took judicial knowledge of our statutes.

The Court: It is all right to put it in this way, however, but when it comes actually to applying the law, it will be applied according to the way it is written.

Mr. Palmer: That is my understanding, that Mr. Jaegerman is putting in facts and not attempting to put in the exact law, but the law will be drawn by the Court from his judicial knowledge furnished by the statutes.

Mr. Jaegerman:

Q. In Tennessee, Mr. McNulty, there is existing an agreement, dated November 19, 1938, covering a deposit of $125,000, with provision for additional deposit to cover liability. The liability is to be determined every six months from the date of the agreement, no valuation basis specified in the agreement, no specific requirement relative to deposit in the law prior to the passage of the act mentioned by the representative from Tennessee, but market values were used as the basis for deposit for evaluation by the Tennessee department; isn't that right?

A. Yes. I might say that deposit agreement has been superseded by—with assignment of the securities there and refers to the new statute that was passed.

[fol. 280] Q. And when was that statute passed?

A. It was in 1939.

Q. In Tennessee as of October 31, 1940, the net cash liability to residents of the State of Tennessee, resulting from the sale of the face amount investment certificates there by Fidelity was $177,947.11, while the deposit, or the market value of deposited securities, was in excess of that amount, or $190,300.

The Court: How many more states do you have, Mr. Jaegerman?

Mr. Jaegerman: Just three.

A. That is right.

Q. In Virginia Series A and B and the Special Annuity contracts were issued and sold by Fidelity Investment Association, being face amount installment investment certificates, and qualification was with the State Corporation Commission?

A. That is right; yes, sir.

Q. And the statutes of Virginia required a deposit of $25,000 in lieu of bond.

A. That is right.

Q. The evaluation was on a fair market value in Virginia, and the net cash liability to residents of the State [fol. 281] of Virginia resulting from the installment face amount certificates, issued by Fidelity Investment Association, amounted as of October 31, 1940, to $525,201.13, while

the market value of the deposit was only $27,250, leaving a deposit deficiency of about $500,000.

A. Yes.

Q. In Wisconsin Series A and Series B were sold by Fidelity Investment Association, and in Wisconsin qualification was with the State Treasurer of Wisconsin.

A. No.

Q. With whom, then?

A. The Banking Commission.

Q. Qualification was with the Banking Commission of Wisconsin and deposit was with the State Treasurer of Wisconsin?

A. Yes.

Q. In Wisconsin there was a statutory requirement, was there not?

A. Yes, sir.

Q. And the deposit is required to cover liability to the extent of 110% of the cash surrender value.

Mr. Lauritzen: The statute does not use the term, "cash surrender value", but in making their deposit the company [fol. 282] has used the term "net cash liability", whatever that means.

Mr. Jaegerman: The statute requires deposit to cover liability to the extent of 110%, and in practice Fidelity has certified a net cash surrender liability to the State of Wisconsin and against which a deposit was made.

Mr. Lauritzen: Not "surrender"; just net cash liability.

Mr. Jaegerman:

Q. What was that net cash liability?

A. That would be the same as the cash surrender value.

Q. And that is what the company used, is it not?

A. Yes, in that connection that 110% of liability—I think it was their ruling that when the securities, the valuation of securities was 90% of the total liability, then additional securities would have to be made which made it really more than 110% of the liability.

Q. Yes. In Wisconsin, as of October 31, 1940, the net cash liability was $2,287,427.24, while the market value of deposited securities was in excess of that amount, or $2,496,541.89.

A. Yes.

Q. And now finally the State of West Virginia also had a statutory deposit requirement, did it not?

[fol. 283] A. Yes.

Q. In the State of West Virginia the Special Income and the Special Annuity contracts were sold, as well as the Series A and B face amount installment investment certificates; isn't that right?

A. In some few instances Series D contracts were sold, too.

Q. That would be scattered instances?

A. Yes.

Q. With what department did you qualify in the State of West Virginia?

A. In the insurance department.

Q. With the Auditor as Ex Officio Insurance Commissioner of the State of West Virginia?

A. Yes.

Q. Prior to December, 1940, was it not your understanding that that qualification was with the securities division of the Auditor's office?

Mr. Palmer: I object to the witness' understanding as to that. I think the statutes of West Virginia speak for themselves, where the required qualification need be, rather than this witness' interpretation of those statutes.

The Court: His understanding may be pertinent also.

[fol. 284] A. Well, as I say, we are under the Auditor and, as Ex Officio Insurance Commissioner, in some instances or some cases matters would be referred to Mr. Brown.

Q. And prior to December, 1940, Mr. Brown had charge of the affairs of Fidelity, rather than Mr. Justice, who has charge of the insurance companies?

Mr. Palmer: I object.

The Court: Overruled. (Exception.)

A. I don't know what they did down there.

Mr. Jaegerman:

Q. Did you personally have any dealings with the office of the State Auditor of West Virginia?

A. In some few instances in making a substitution of securit[illegible], I would secure his approval for the substitution.

Q. In those instances, what individual did you see and what individual transacted your business with you?

A. I think I called on Mr. Brown.

Q. Mr. Robert Brown?

A. Yes, sir.

Q. What was his title?

A. Deputy Securities—well, I am not sure.

Q. Deputy Securities Commissioner?

A. I think that was his title.

[fol. 285] Q. It was Deputy Securities Commissioner of the State of West Virginia?

A. Yes.

Q. Are you familiar with the license that the Fidelity Investment Association had from the then Auditor of West Virginia, prior to December, 1940?

A. Yes, sir.

Q. Under the statutes of West Virginia, in addition to the liability on certificates sold in West Virginia, deposit was required against liability on certificates sold in all other states which did not have a deposit requirement; isn't that right?

Mr. Palmer: If the Court please, that is a direct question of what is the statute of West Virginia, and I think this witness is not one qualified to give that statute unless——

Mr. Jaegerman: Pardon me, but what I am asking is his understanding, and the practice he followed as a responsible officer of Fidelity.

The Court: The objection is overruled. (Exception.)

Mr. Palmer: Certainly the question does not say what is the statute.

The Court: If the question does not say that, it is just [fols. 286-289] this witness' understanding, and the Court will be governed by the statute, itself.

Mr. Jaegerman: I will reframe the question, your Honor.

Q. In making the deposit with the State of West Virginia, what was your understanding as to the measure of deposit liability, as required by the State's statute?

A. Well, it was in addition to the statutory requirement, it was to cover 100% of the cash liability on all contracts, you might say, credit for deposits maintained in other states.

Q. And did the company follow that requirement as you have explained it?

A. Yes, that was the method used.

[fol. 290] Mr. Jaegerman:

Q. Mr. McNulty, yesterday we went through the various states which, either by statute or by agreement, required Fidelity Investment Association to make deposit of securities with the state, and I show you what I have had marked for identification as Exhibit No. 10, and ask you whether you can identify it.

A. Yes, this information was furnished you.

Q. This was information furnished me at my request by the Fidelity Assurance Association, cash liability and deposit for the State of Wisconsin, February 28, 1941, broken down as to cash liability by series and by funds within the series, and the market value of deposit of securities belonging to the various series and funds; is that right?

A. Yes, sir.

[fol. 291] Q. Was this prepared under your direction pursuant to my request?

A. Yes, sir.

Mr. Jaegerman: I show it to Mr. Lauritzen, representing the State of Wisconsin (handing paper to counsel).

Mr. Lauritzen: I think that is correct, Mr. Jaegerman.

Mr. Jaegerman: We offer this in evidence as Exhibit No. 10.

Exhibit No. 10 Filed

Q. Mr. McNulty, referring to several of the figures appearing on this Exhibit No. 10, it appears that the cash liability of Special Annuity Fund was $375,355.10 and the market value of the deposit of securities belonging to the Special Annuity Fund was only $238,730.01, being a deposit deficiency, as applied to that fund, while Special Annuity M. & R., which was maturity reserve for Special Annuity contracts, had a cash liability of $26,628.97, and no securities belonging to that fund were on deposit with Wisconsin; is that right?

A. Yes, sir.

Q. On the other hand, Income Reserve Series A had a cash liability to residents of Wisconsin of $178,567.43; is [fol. 292] that right?

A. Yes, sir.

Q. And the market value of securities belonging to Income Reserve Series A Fund was $506,151.26.

A. That is right.

Q. Being an excess deposit of securities belonging to that fund of approximately in excess of $300,000?

A. Yes, sir.

Mr. Jaegerman: Your Honor, yesterday you asked me whether I could break down that West Virginia deposit and liability, which was an accumulative one of the various states. I am having that prepared at Wheeling, West Virginia, and the information will be telephored in some time this morning.

The Court: All right.

Mr. Jaegerman: I want to make one correction of my question yesterday. I inferred that the $7,029,994.59 of the net cash liability shown for West Virginia would be applicable to contracts sold in West Virginia. Is that correct, Mr. McNulty?

A. No.

Q. What is the correct answer to that?

A. Well, that would include the liability in states in [fol. 293] which no deposits were maintained or required.

Q. Or liability in states where the deposit maintained was insufficient to cover the full liability?

A. Yes.

Q. What approximately was the actual liability in West Virginia applicable to certificates sold in West Virginia?

A. Well, I could not say exactly; approximately $2,000,000.

The Court: I don't believe I understand this last question or two, Mr. Jaegerman. Altogether in West Virginia there was better than eleven million dollars?

Mr. Jaegerman: Yes, your Honor, eleven million, three hundred thousand.

The Court: Now, there was a margin of better than four million dollars that was applicable to contracts sold in other states where there was no deposit, was there not, or what is that four million for?

Mr. Jaegerman: You are referring, your Honor, to the seven million dollars net cash liability, and the eleven million dollars quoted market value of securities on deposit?

The Court: Yes.

[fol. 294] Mr. Jaegerman: That would leave a round four million dollars surplus, but actually if one compares the value of the securities deposited in other states with the liability in those states, the deficiency is substantially in excess of four million dollars.

The Court: This four million dollars, then, is to cover the deficiency in states where deposits are required; is that right?

Mr. Jaegerman: This deficiency is due to the fact that the deposits in West Virginia were made at book value, and not at market value, and the shrinkage between book and market values accounts for the deficiency.

The Court: I want to know what that spread of four million that we have in West Virginia as of that date is applicable to.

Mr. Jaegerman: Your Honor, of the seven million liability figure, which I gave for West Virginia, two million is applicable to contracts sold in the State of West Virginia, and five million is applicable to states in which certificates were sold, but no deposits at all were made.

The Court: Now, what about the extra four million between that and the eleven million, the difference between the seven million and the eleven million, or the four million [fol. 295] dollars; what about that?

Mr. Jaegerman: Your Honor, the difference between the seven million and the eleven million, or the four million dollars, is applicable to states which required a deposit, but where the deposit was insufficient to cover the liability on those states requiring deposits.

The Court: All right; that is what I wanted to know.

Mr. Lauritzen: Mr. Jaegerman, do I understand there is some segregation made of the West Virginia fund, as to what the two million dollars is for, and what the five million dollars is for, and what the four million dollars is for, or is that your own or the company's breakdown of those figures?

Mr. Jaegerman: I understand Auditor Sims is under subpoena, and that certainly is one of the questions we will ask him when he takes the stand. The figures I gave, of course, are from the certified audit prepared by the auditors retained by the Fidelity Assurance Association.

Mr. Lauritzen: The only facts you have on that point are as shown in the compilation of the Haskins & Sells audit of 1940; is that right?

Mr. Jaegerman: No, plus information furnished by the company and obtained by me in my investigation.

[fol. 296] Mr. Lauritzen: Have you got that information here?

Mr. Jaegerman: You mean the additional figures?

Mr. Lauritzen: Yes.

Mr. Jaegerman: As explained to the Court, I have requested the employees in Wheeling to give me a tabulation, which should be here today, and which I will offer in evidence. Perhaps we could reserve an exhibit number for that right now, your Honor.

The Court: All right, you may do that.

Mr. Jaegerman: Very well, that will be Exhibit No. 11, which will be a statement of the net cash liability in states which do not require a deposit of securities, and that figure will be as of October 31, 1940, which was the latest audit taken.

(Exhibit No. 11 To Be Filed)

Mr. T. C. Townsend: That is four million dollars?

Mr. Jaegerman: No, it will be approximately five million dollars, but I cannot give you the exact figure, Mr. Townsend.

The Court: All right; let us proceed.

Mr. Jaegerman:

Q. Mr. McNulty, I want to go into the question of the states in which Fidelity Investment Association sold face amount installment certificates, where no deposit of securi-

[fol. 297] ties were required. Were you qualified in Arkansas.

A. Yes.

Q. Did you not sell the Annuity Contract in Arkansas?

A. Yes.

Q. With what state commission or department did Fidelity Investment Association qualify?

A. The Arkansas Railroad Commission, as I recall.

Q. And it was the Securities Division of the Arkansas Railroad Commission?

A. Well, I know it was the Railroad Commission, I don't know whether they had a division there or not.

Q. Mr. McNulty, did not Fidelity Investment Association sell the Special Annuity, the Special Income, the Series A

and the Series B face amount installment investment certificates in the District of Columbia?

A. That is right.

Q. Was registration or qualification necessary with any agency there?

A. No.

Q. Mr. McNulty, did not Fidelity Investment Association sell the Annuity Contracts, face amount installment investment contracts, in Florida?

A. Yes.

[fol. 298] Q. With what department was Fidelity registered there?

A. The Securities Commission, as I recall.

Q. Mr. McNulty, did not the Fidelity Investment Association sell the Series A, and the Series B face amount installment investment certificates in the State of Georgia?

A. Yes, it did.

Q. With what department in Georgia did Fidelity qualify?

A. I think it was with the Securities Division or Securities Commission; I don't recall the exact title.

Q. Mr. McNulty, did not Fidelity Investment Association sell the Special Annuity Contract and the Series B contract in Louisiana?

A. I am not certain about the Annuity Contract. It did sell the Series B, I know.

Q. With what department in Louisiana did Fidelity qualify?

A. The Securities Department.

Q. Did not Fidelity Investment Association sell the Special Annuity, the Series A and the Series B installment face amount certificates in Michigan?

A. Yes, sir.

Q. With what department in Michigan did Fidelity [fol. 299] qualify?

A. The Department of Insurance.

Q. Did not Fidelity Investment Association sell the Special Annuity Contract in Mississippi?

A. Yes, it did.

Q. With what department in Mississippi did Fidelity qualify?

A. I think we qualified there under the Secretary of State. I don't know whether they had a Securities Division or not, but it was with the Secretary of State.

Q. Did not Fidelity Investment Association sell the Special Annuity Contract in the state of Maine?

A. Yes, they did.

Q. With what department in Maine did Fidelity qualify?

A. I think that was with the Department of Banking.

Q. The Department of Commerce, wasn't that the name?

A. I think so.

Q. And more particularly the Commissioner of Securities in the Department of Commerce?

A. I think so.

Q. Was the Special Annuity contract sold in the State of New Jersey by Fidelity?

A. I think it was, yes.

[fol. 300] Q. Was there qualification in New Jersey?

A. Yes, we were qualified there under the Department of Insurance and Banking.

Q. Sales were discontinued after Fidelity Investment Association's wholly owned subsidiary, Fidel Association of New York, Inc., was qualified to do business?

A. That is right.

Q. Mr. McNulty, did not Fidelity Investment Association sell the Special Annuity Contract in North Carolina?

A. Yes, sir, it did.

Q. With what department in North Carolina was qualification obtained?

A. The Securities Department.

Q. Did not Fidelity sell the Special Annuity face amount installment investment certificates in North Dakota?

A. Yes, it did.

Q. With what department was qualification obtained?

A. With the Securities Department.

Q. Mr. McNulty, did not the Fidelity Investment Association sell the Special Annuity Contract and the Series A contract in Oklahoma?

A. Yes.

Q. With what department was qualification obtained?

[fol. 301] A. With the Securities division or department. Now, I am giving you these departments from memory, as I remember them. I cannot be certain of the exact title of them.

Q. Was the Oklahoma Securities Commissioner the securities division of the State Banking Department?

A. I think that is right.

Q. Mr. McNulty, did not the Fidelity Investment Association sell the Special Annuity investment certificate in South Dakota?

A. It did.

Q. With what division was qualification obtained?

A. As I recall it was the securities division or Securities Department.

Q. Finally, did not Fidelity Investment Association sell the Series B certificates in South Carolina?

A. Yes, it did.

Q. With what department in South Carolina was qualification obtained?

A. With the Department of Insurance through the secretary of the Securities Commission or division; I don't recall the exact title.

Mr. Jaegerman: As explained, your Honor, we will have, [fol. 302] I think, today the net cash liability as of October 31, 1940, in these various states where no deposits were required and on which deposit was maintained with the State of West Virginia.

The Court: All right.

Mr. Jaegerman:

Q. Now, Mr. McNulty, at various times did not representatives of the state agencies, with which Fidelity was qualified, visit Wheeling, West Virginia?

A. Yes, sir.

Q. And was it not part of your duties to see that their wants were satisfied and any questions they might have would be answered?

A. Yes, sir.

Q. When these representatives of the various state departments visited Wheeling, were they permitted to examine the various books and records of Fidelity Investment Association maintained by it at its home office?

A. Yes, sir.

Q. And did not they, in fact, examine these books and records?

A. In most instances they did.

Q. And you were present when they examined them, and you answered questions that might have been asked you by [fol. 303] them, or you made available other members of

the staff who could answer detailed questions on accounting and bookkeeping?

Mr. Schurr: Your Honor, I object to this type of examination unless they specify what states and persons had conversations with him and which ones inspected their books and records at Wheeling. We don't want that to mean that Missouri is involved in such procedure as that.

Mr. Jaegerman:

Q. Well, let us take the State of Missouri. Did not, from time to time, representatives of the State of Missouri visit the home office of Fidelity Investment Association at Wheeling, West Virginia?

A. Yes, representatives of Missouri have been in Wheeling.

Q. And did not representatives of the State of Wisconsin visit Wheeling?

A. Yes, sir.

The Court:

Q. And did representatives of Wisconsin and Missouri look over the books?

A. I know the representatives from Wisconsin did definitely; and as to Missouri, that was more or less of a discussion or a conference.

Mr. Lauritzen: Would you bring out when these visits [fol. 304] took place, Mr. Jaegerman, on the part of Missouri or Wisconsin officials to Fidelity?

Mr. Jaegerman:

Q. Did not representatives of the State of Illinois visit the home office of Fidelity Investment Association at Wheeling, West Virginia?

A. I don't recall Illinois.

Q. What other states, if any, do you recall had representatives visit the home office of Fidelity Investment Association at Wheeling, West Virginia?

A. Virginia, Tennessee, Iowa—those are all I can recall offhand.

Q. Ohio.

A. Oh, yes, Ohio.

Q. To the best of your recollection, Mr. McNulty, will you please identify the approximate time or times as to these various visits by representatives of the states you have mentioned?

A. Well, the states of Wisconsin, Virginia and Tennessee in June, 1939. They conducted an examination then. The State of Virginia was more recently, about in March, I would say.

The Court:

Q. What year?

A. March of this year. I am not certain on Ohio. I think [fol. 305] the last time they were there was about, possibly, two years ago.

Mr. Jaegerman:

Q. These other dates, were the dates of the last visit?

A. The dates on which I feel certain an examination of the books was made on their visit there is Wheeling.

Q. And with which you are famiilar?

A. Yes.

Q. Ohio was down some time in the summer of 1938; isn't that right, at the same time the representatives of the Securities and Exchange Commission were there?

A. Yes, sir, they were.

Q. How about West Virginia? Did they have representatives visit the office?

A. Well, on some occasions they did visit there, although the audit report there was taken as an examination.

Mr. Lauritzen:

Q. I did not hear you.

A. The audit report was used by West Virginia in place of a real examination themselves, although at various different times in past years, they have had their representative participate in the annual audit.

Mr. Jaegerman:

Q. You mentioned an audit report, Mr. McNulty, what audit report was that?

[fols. 306-324] A. The annual audit report conducted by the auditors hired by the association.

Q. And the auditors that were hired, did that hiring take place after conferences with the State Auditor of West Virginia?

A. On several occasions it did.

Q. It was an anditor that was approved—in some instances, then, the choice of independent public certified accountants to conduct the annual audit was approved by the Auditor of the State of West Virginia?

A. That is right; yes, sir.

Q. Did not the Anditor at one time make an independent examination of Fidelity back in 1932 or '33?

A. Well, he did engage a firm, an auditing firm from Charleston or Huntington to participate with the auditing firm that the association had hired.

. . . . . .

[fol. 325] Mr. Jaegerman:

Q. You are familiar with the way the books and records of Fidelity are kept, are you not?

A. Yes, sir.

Q. With respect to the segregation by funds and by series?

A. Yes, sir.

Q. And with the fact that securities are purchased with moneys that are allocated to the particular funds, and the securities, in turn, are allocated to these funds and series?

A. Yes.

Q. And that information is clearly set forth on the books and records of the company; is it not?

A. Yes, sir.

Q. Now, the various state officers who visited the office of the Fidelity were permitted to see these various books and records, were they not?

A. They were permitted to see anything—to see any and all records.

Q. And in fact that was the purpose for which they came [fol. 326] to the office of Fidelity, as explained to you?

Mr. Schurr: I object to that question; unless it is made more definite and certain, and not such a general question. Let him specify whom and the time.

Mr. Jaegerman: The witness has already specified exactly what states had representatives at the office of Fidelity, and the various dates on which these visits were made.

Mr. Schurr: No, he has not.
The Court: The objection is overruled.

(Exception.)

A. Yes, to determine the general financial condition and also to check on the deposit of securities for the liability.

Mr. Jaegerman:

Q. And on occasions you explained to these representatives what we might describe as the fund theory or the series——

Mr. Lauritzen: I object.
Mr. Jaegerman: I will withdraw the question.
Mr. Lauritzen: You say he has stated just when these people were there? I don't think he has done that.
Mr. Jaegerman: You can bring that out on cross-examination.
Mr. Gray: That question is decidedly leading, if the [fol. 327] Court please.
The Court: Well, it has been withdrawn.

Mr. Jaegerman:

Q. Mr. McNulty, perhaps we will save time if you will make a statement of the general business as conducted by Fidelity Investment Association, the manner in which the business was conducted.

A. Well, it was engaged in the business of issuing and collecting payments on installment savings, what I would term an installment savings contract, calling for certain stipulated monthly payments over a period of months or years, at which time the contractor at maturity had the option of taking a lump-sum settlement or an annuity for a certain number of years. In fact, the type of settlement was optional with the contractholder.

Mr. Palmer: May I ask if that is not true only up to 1940, that after that time the business of the company was changed?
Mr. Farmer: Isn't this repetition? I thought I heard it yesterday. I know Mr. Fleming went into a lot of things about the contracts.
Mr. Jaegerman: We are not going into the contracts, but the conduct and nature of the business, which is highly im-

portant and relevant to the questions raised in the plead-
[fol. 328] ings.

Mr. Farmer: I object on the ground of repetition.

The Court: Overruled.

(Exception.)

Mr. Jaegerman:

Q. Until December 31, 1940 Fidelity Investment Association was engaged in issuing and selling installment investment certificates, face amount certificates; isn't that right?

A. That is right.

Q. That is the only type of certificate or investment that was being issued and sold by Fidelity Investment Association; is it not?

A. That is right.

Q. After that date did the company sell anything at all?

A. Not after December 31, 1940.

Q. After that date did the Fidelity Investment Association engage in any business whatsoever?

A. No, they did not.

Q. After that date did not Fidelity Investment Association only continue servicing the face amount certificates that had been issued and sold prior to that date?

Mr. Palmer: I object. I don't believe the purpose of that question is quite fair, in that the corporation had a
[fol. 329] right to do certain business after that time, and whether they engaged in it or not, of course, is also a matter of proof. They had a right to engage in other business.

The Court: This should be brought out by this witness.

Mr. Reinhardt: Your Honor, I think that is proper on cross-examination. As a matter of fact, I would like to observe that the examination of this witness has been peppered with a great many interruptions, many of which relate materially to what should properly be brought out on cross-examination. We are not objecting, but we are now endeavoring to present a full picture of this case, and we would like to present it in the manner we think would be most helpful to the Court. Any additional information which other counsel believe would be helpful, I think should properly be brought out on cross-examination.

The Court: Let us get along with it and expedite the examination as fast as we can.

Mr. Jaegerman:

Q. The installment investment certificates, sold by Fidelity prior to January 1, 1941, called for periodic payments to Fidelity, did they not?

A. They did.

[fol. 330] Q. Monthly?

A. Monthly, quarterly, semi-annually or an annual payment for a certain number of years or months.

Q. Now, Mr. McNulty, trace the handling of these payments as they were received.

A. Well, practically the large percentage of payments received were received by mail, and in some cases received in the branch offices or in collection banks, which acted as collection agencies, which in turn was transferred to the home office at Wheeling. The payments, when received there, would be allocated on the books to the proper account, the distribution of the payment as to the commission payments.

Q. That would be selling commissions?

A. Yes.

Q. What would other accounts be?

A. Well, in Series B would be the allocation for the insurance premium and for the amount necessary to the reserve and the contract holder's particular account was credited with that payment, and the money then was deposited in a bank account in whatever particular series that money was received, which in turn was used for investment purposes as the investment committee saw fit.

[fol. 331] Q. What was the mechanics of investment?

A. Well, that would be handled by the investment committee upon recommendation of the investment experts, or counsel employed by the association.

Q. Who maintained offices in New York City?

A. Yes, sir.

Q. He would make certain recommendations to the investment committee, which would either approve or disapprove those recommendations?

A. Yes, sir.

Q. If those recommendations were approved, then what happened?

A. Well, the investment man would proceed with the purchase of securities and the securities would then be possibly held for safe-keeping, maybe, for a time or deposited with any one of the various state departments.

Q. When a purchase was made, how was it paid for?

A. Well, it was charged to the—paid for in cash.

Q. Where was that cash; where did you get the cash?

A. They accumulated it from the payments made by contract holders to the association.

Q. And it was cash that would belong to one particular fund; is that right?

[fol. 332] A. Well, to any one of the various funds. That would be held separate for that particular fund.

Q. And the purchases that were made would be purchases that would be allocated to the fund from which the cash was derived?

A. Yes, sir.

Q. And what was done with the securities after they had been purchased and after they were no longer being held in safekeeping?

A. They were deposited with the State of West Virginia, or any other state where an additional deposit was required or requested.

Q. Would a letter of transmittal accompany these securities that were sent to the various states for deposit?

A. Well, I have seen copies of letters. I did not handle that particular end of it.

Q. Who did handle that?

A. Mr. Hubert Young of New York.

Q. Did you have a department in connection with cash surrenders or maturities?

A. Yes, we maintained a department in the Wheeling office for that particular end of it.

[fol. 333] Q. When a request for cash surrender came in, what would be done?

A. Well, of course the account would be checked and the verification made as to the registered owner, the number of payments credited to the account, and then it would be determined, of course, as to the cash surrender value of that contract at any particular payment which is shown by schedule, and after verification and checking, it would be turned over to what we call the cash disbursements department for the issuance of a check to the registered owner.

Q. From what funds or against what funds would that check be drawn—an example, for instance?

A. Well, for instance, if it was an Annuity Contract, that would be charged to the annuity contract account, and all records are kept separate for the annuity account. That would deal only with the annuity account.

Q. Was not there a time that certain of these series ran short of cash with which to meet these demands for cash surrenders and maturities?

A. Yes, that is true, particularly the income account.

Q. The income account? What happened there?

[fol. 334] A. Well, at that particular time in the maturity demands on the old Special Income Contract—those were claiming a heavy percentage at that time. Of course, that was possibly in 1932 and '33, where the heavy demands for the maturity settlements of income contract and the securities at that time were depressed. They did not have the field—I am assuming this now—they did not want to sell the securities to raise cash to pay those maturity demands, and money from some of these other funds, on which payments were being continued, we were having an income of cash, rather than an out-go, and that was used to pay those income contracts, rather than sacrifice the securities at that particular time to raise the cash.

Q. How were the mechanics handled, and was there a joint bank account for two or three of these funds?

A. What?

Q. A joint checking account or deposit account?

A. On our book, of course, we had them segregated, but there was one general bank account.

Q. That was back in 1932 or '33?

A. Yes, in 1932 or '33.

Q. And what was the result of using cash from the later series of funds to pay off cash surrenders and maturities of [fol. 335] the earlier series?

A. It resulted, of course, in an overdraft on our books in that particular account.

Q. So that every dollar which was used of money of a later series to pay off an earlier series would be reflected on your books originally as an overdraft?

A. That is right.

Q. Did this continue on beyond 1932 and '33?

A. I think it continued beyond 1932 and '33, on up until some time in 1938, at which time these overdrafts were

eliminated on our books by adapting accounts payable and accounts receivable to or from these funds in question.

Q. Then overdrafts were solidified or frozen into accounts payable and accounts receivable between the various funds where the overdrafts had originally occurred?

A. Yes, sir.

Q. And what was the approximate amount of the overdrafts as reflected today on the books of the company between these various funds?

A. You mean as a total, altogether?

Q. Yes, the total one fund would owe another fund, separately by funds.

[fol. 336] A. I would say the income contract account owed the annuity account somewhere around $700,000, or $750,000.

Mr. Lauritzen: What date is that?

Mr. Jaegerman:

Q. If you want to give me an exact date, let us take June 6, 1941. I believe the figures were actually taken off as of that date.

A. Yes, that is right. I cannot give you the exact figures.

Q. Approximately.

A. I would say that the income account owed approximately $1,000,000 to the annuity account, and the income reserve series A account. It is seven hundred and some thousand to the annuity account and two hundred and forty or fifty thousand to the series A account.

Q. Are there any other funds that are owing to funds; that is, are there any other inter-fund loans and advances perhaps affecting the general fund or other contract funds?

A. I cannot say definitely whether it shows in that or not. The general fund owed the contract fund about $62,000, which we call a frozen balance there.

Q. I think this is the first time we have mentioned the general fund. Explain what the general fund is.

A. Well, what we call the general fund is really the stock-[fol. 337] holders' account.

Q. So that the bookkeeping of the company reflects the funds by series, and a general fund, which is a stockholders' fund but not a series fund?

A. That is right; yes, sir.

Q. However, this general fund, or stockholders' fund, is liable for any deficiencies in any of the contract funds; is it not?

A. I would say so; yes, sir.

Q. If you know, how was the general fund created?

A. By the capital structure originally, which has been supplemented by any earnings or income of the investments of that particular account.

Q. And earnings which were allocatable to stockholders, being surplus earnings of certain funds above what was required to improve them?

A. That is right, on the maturity requirement reserve.

Q. All earnings from sales, if there were any, net earnings, might go into the general fund; is that right—net profit on new sales, that is?

A. Yes, the association's portion of income from the sale of contracts.

[fol. 338] Q. And profit on lapsation, or cash surrender, if there were recoveries from reserves, bookkeeping was used to transfer that to the general fund.

A. Yes, that is right.

Q. Mr. McNulty, are you familiar with the practice of Fidelity Investment Association of selling securities from one fund to another fund?

A. Well, I know that—I know of the practice and the policy of the association in that respect, yes.

Q. The inter-fund transfer of securities—that is the way you describe it, is it not?

A. Yes.

Q. During what period did these inter-fund transfers occur?

A. Well, they occurred from time to time at various periods.

Q. As early as when?

A. Oh, I could not recall the first.

Q. 1930 or '31?

A. I would say approximately around that date.

Q. What officer or what employee in Fidelity Investment Association would be most familiar to testify as to the inter-fund transfers of securities?

[fol. 339] A. Well, that would of course be handled as an investment. It would be under the direction of the invest-

ment committee, who in turn would authorize Mr. Young, who had charge of purchases and sales of securities.

Q. That would be Hubert R. Young in New York?

A. That is right.

Q. I believe you testified before that advances to salesmen and to sales representatives were the substantial factor which resulted in the National Sales Agency, Inc., notes of approximately one million dollars.

A. That was substantially true, yes.

Q. Did these advances to sales representatives continue——

A. Pardon me, there, you say advances to salesmen. These advances to the National Sales Agency, that one million dollars, I don't want to be construed as meaning that was advances to the individual salesmen.

Q. No, the Fidelity Investment Association made substantial advances to National Sales Agency, Inc.?

A. That is right.

Q. And these advances aggregated about one million dollars?

A. Yes, sir.

[fol. 340] Q. And the moneys were used by National Sales Agency, Inc., in turn, to make advances to its sales representatives?

A. To handle the sales program for expansion purposes, branch offices, and so on.

Q. And when was the National Sales Agency, Inc., discontinued?

A. 1933—no, it was 1934.

Q. What was the set-up with respect to sales after 1934?

A. Well, it was handled by the agency division, which was created to operate for the National Sales Agency.

The Court: I thought I heard all that yesterday, Mr. Jaegerman. What is the use in going over it again?

Mr. Jaegerman: I wanted to show there were additional advances beyond that time, and very substantial amounts, to sales representatives. This is the background.

The Court: There is no use going into the same evidence we had on yesterday.

Mr. Jaegerman:

Q. Subsequent to 1934 and continuing right through 1940, were not additional substantial advances made to

sales representatives, sales supervisors and employees in the selling department?

[fol. 341] A. That is true, yes.

Mr. Jaegerman: That is all, your Honor.

The Court: Mr. Palmer, do you have any questions to ask the witness?

Mr. Palmer: Yes, your Honor.

The Court: Then proceed with the cross examination.

By Mr Palmer:

Q. Mr. McNulty, the company had certain ways of making profits, did it not?

A. Yes, sir.

Q. Now, using for example a contract of $100 a year. If a person paid in the $100 on that and wanted to quit the company, he only got back $39, did he not, approximately?

A. Well, he would get whatever the cash surrender value would be for that particular contract.

Q. And it amounted to between twenty and forty dollars a year, did it not?

A. That would depend on the type of policy.

Q. Well, on any type of policy it did not amount to over $40 a year, did it?

A. I don't think it did.

Q. Now, if a man took the same $100 and put it into a [fol. 342] baby bond or savings bank, he got back the $100 at the end of a year, did he not?

A. I don't know.

Q. So that the balance between what was paid in and what was paid back out was profit to the company for its sales and keeping it that year; is that right?

A. It was not profit for the company for its sales; it was income for the company to defray expenses of sales.

Q. And the company made a profit on that, did it not?

A. Naturally; at least that was the intention of it.

Q. Now, the company had a large part of their policyholders who took their cash surrender value; isn't that right?

Mr. Reinhardt: Let me interrupt. I want to object to the preceding question unless it is identified as to the time when this company made a profit. It seems to me that the mere fact that it is in this situation that it is in now would

indicate that it did not make a profit, and if it did make a profit, I would like to know when.

The Court: The answer of the witness simply was that it was the intention of the company to make a profit. He did not say the company did make a profit.

Mr. Palmer: They made a profit on the transaction of [fol. 343] which I am speaking, after all expenses and everything else had been settled.

The Court: Overruled.

(Exception.)

Mr. Palmer:

Q. And is it not a fact, and did not Mr. Risley, its president, so admit before the SEC in 1938, the company made from that transaction a profit of three million dollars a year?

A. I don't recall any such testimony. I am not familiar with that.

Q. Are you familiar with the figures that the company, by virtue of its policy holders taking their cash out, made a profit of practically three million dollars a year on that transaction?

A. No, sir, I never heard that figure. I am not familiar at all with that.

Q. It is true, is it not?

A. No, I would say it is not.

Q. Will you deny the testimony of the president of your company, taken before the Securities and Exchange Commission?

Mr. Fleming: The debtor objects.

A. I don't know what evidence he gave.

The Court: I think it is not proper to ask this witness to [fol. 344] deny something you have there.

Mr. Palmer: I think you are right, your Honor.

Q. Now, let's see, your company had another means of profit: if a man quit paying at the end of, say, any period of time, and if then he wanted to take the policy up again after one or more years, you did what you call redated the policy, did you not?

A. That is right.

Q. That redating meant that if originally his policy was to mature at a certain date, you just dated it back the

amount of time he had not paid anything in on it; is that right?

A. Yes.

Q. During that time you had his funds in the company's hands, the reserve part of it, did you not?

A. Yes.

Q. But when it was redated you did not give him any interest on that money that you had kept during the time of the redating period or lapsed period of payments?

A. That is right.

Q. And that was a profit to the company?

A. No, I would say that remained right in the reserve fund; that amount was not transferred to the stockholders [fol. 345] or general fund.

Q. At a certain period of time certain moneys in the reserve fund were divided half between those who matured their contracts and the stockholders of the company; isn't that right?

A. No; the contract provided for a distribution of surplus. On some series of contracts contract holders were entitled to a full amount of surplus apportioned to the contracts.

Q. That was the early contracts?

A. Yes.

Q. What about the rates?

A. The contract holders to participate up to 50% in the amount of any surplus in the fund.

Q. And the other 50% went to the stockholders of the company?

A. That was the intention and the contract so provided.

Q. And that is what happened, they took it in dividends?

A. I cannot answer that; I don't recall when the transfers were made.

Q. But it was transferred to the general fund and from [fol. 346] the general fund you paid dividends?

A. There were transfers; I don't know whether it was all taken out or not.

Q. And from that source alone did not you make $300,000 a year?

A. I don't recall, but I would say no.

Q. Now, then, whenever a person borrowed money, whenever he borrowed back the money he had put into the company, you charged him 6% interest on it, did you not?

A. That is right.

Q. And from that the company made profits, didn't it?

A. No.

Q. It did not?

A. That was classed as an investment of the particular contract fund that the loan was made in. The general fund did not make that loan and did not receive the 6% interest.

Q. Who did receive it?

A. The contract fund itself received that.

Q. The contract fund?

A. Yes.

Q. Now, the contract funds which went to maturity, there were only 5.29% of all those who put their money in, who [fol. 347] ever got it out at maturity; isn't that right?

A. I cannot answer.

Q. Will you deny those figures filed before the SEC in 1938?

A. No.

Q. Then if only one out of twenty reaches maturity to divide the fund, the stockholders got the rest of that fund; did they not?

A. No.

Q. Who did get it?

A. None of those funds matured in its entirety. Any surplus in a fund that the contract holder participated 100% in the surplus, the contract holders would have gotten that.

Q. But only one out of twenty contract holders ever reached that place where they could get that; isn't that right?

A. I am not in position to say.

Q. And the other nineteen took a loss and then the fund was there, and the profit on the nineteen was taken by the stockholders; isn't that right?

A. I don't know; I can't say.

Q. Now, let's see something else. The first contract you [fol. 348] sold was the Special Income; isn't that right?

A. Yes.

Q. And when that came to maturity, as to the 5% who did mature them, you could not pay that out and had to borrow from another fund which you had set up by selling people at a later date; isn't that right?

A. Approximately what I testified to before, yes.

The Court: Are you undertaking to say that this company has not carried on its business properly and that they

have gotten that much in dividends, or something like that?

Mr. Palmer: Yes, sir, I am attempting to show the impossibility of a reorganization of this company in this type of procedure——

The Court: How would that tend to show it?

Mr. Palmer: If they could not carry it on, your Honor, over a twenty-year period and make the company profitable at the end of that time, how in the world can they expect, without new capital structure, to come in this Court and say, reorganize the company and the same group will run it again in the same fashion and make money for the contract holders?

The Court: There has been no intimation that the same group will run it again.

[fol. 349] Mr. T. C. Townsend: Or that it will be run in the same fashion.

The Court: Or that it will be run in the same fashion, no; and so far as the other evidence is concerned, any evidence that the company has taken out large dividends and thereby caused the situation in which it is now, would tend, in my mind, to show a better possibility of reorganization than if they had never been able to get any dividends.

Mr. Palmer: Your Honor, we would like to show that on the first series contracts sold, not more than 5% went to maturity, and they could not even pay those off, and never have without borrowing from another fund; that the second fund came along, and they could not pay it off without borrowing from another fund; in other words, so long as they had a selling plan creating new funds all the time and money profits from selling, the snowball continued; but as soon as the selling stopped, the house of cards fell.

The Court: I can see all that, but I don't see the pertinency of it to the question of whether or not there can be a reorganization, but if you think it is pertinent to that issue, you may go ahead to a reasonable extent.

Mr. Palmer:

Q. Now, a further thing, Mr. McNulty: what class of stock did you have?

[fol. 350] A. Personally?

Q. No, no, the company.

A. Originally they had common stock and now, presently, there is common and preferred both.

Q. And the preferred stock amounted to about 9,110 shares sold; is that right?

A. Yes, sir.

Q. And is it not a fact that in 1930 up to 1932 that stock was issued, the preferred stock?

A. I think so.

Q. And is it not a fact that your company and your company's agent, the National Sales Agency, went to the few persons who did mature their contracts during that period and sold them 5100 shares of this preferred stock out of their matured contracts, so that even those persons who had matured contracts did not get their money back, but got back stock of your company instead?

A. I could verify the exact figures, but I know that policy was pursued at that time.

Q. And it amounted to approximately five and a half million dollars paid to the matured contract holders, and immediately by them used in the purchase of preferred Class A stock; is that right?

[fol. 351] A. How much money?

Q. Five and a half million dollars.

A. The total outstanding preferred stock is only nine hundred thousand; I don't know where that five million dollars comes in, in purchasing nine hundred thousand dollars in stock.

The Court: I think you have an extra cipher on there, Mr. Palmer.

Mr. Palmer: Approximately five and a half million of sales value of contracts was used, which gave a cash surrender of around five hundred thousand, which was used to purchase the stock; is that correct?

A. I cannot verify those figures; I don't know.

Q. They are approximately true, are they not?

A. I don't know.

Q. You were the secretary, who had the issuance of the stock in charge, were you not?

A. I was the assistant secretary at that time.

Q. And don't you know that more than half of that preferred stock was issued to persons who had contracts which they cash surrendered or matured at that time?

A. I know that a substantial amount of the stock was issued by that method, yes.

[fols. 352-354] Q. Would you say that more than 2% who have ever put their money into Fidelity have gotten it out at maturity?

A. I cannot say; can't make a statement as to that.

* * * * * * *

[fol. 355] Q. So far as the Commissioner of Securities is concerned in Missouri, he had no knowledge about this breakdown, as shown on this Exhibit No. 8?

Mr. Jaegerman: I object.

A. I don't know whether he had or not.

The Court: If this witness knew, it would be all right.

The Witness: I didn't know; I didn't have knowledge of that.

Mr. Schurr: Now, I am going to show you what has been marked Exhibit No. 16-A, purporting to be a certification from the Wheeling Dollar Savings & Trust Company of Wheeling, West Virginia, showing the deposits in the different funds that those deposits are to secure, and ask you whether or not that was mailed along with Exhibit No. 16 to the Secretary of State of Missouri.

A. Yes.

Q. Do you see anything on Exhibit 16-A with reference to a breakdown of Special Annuities and Special Annuities M. & R.?

A. No.

Q. Do you see anything on Exhibit 16-A with reference [fols. 356-358] to a breakdown of Income Reserve Series B, and Income Reserve Series B, M. & R.?

A. There is a breakdown here on the Income Reserve Series B.

Q. Just on B?

A. Yes.

Q. In other words, they grouped Series B and Series B, M. & R. together?

A. Yes.

Q. And also on this report by you, you group them together, do you not?

A. Yes.

Q. And on this report, Exhibit No. 16, you group together Special Annuity and Special Annuity, M. & R., do you not?

A. Yes.

Q. And Income Reserve Series A, do you not?

A. Yes.

Q. You never did submit a breakdown as shown in Exhibit No. 8, submitted to the Securities and Exchange Commission, to the State of Missouri, did you?

A. I don't know whether we did, or not. That report, as I recall, I am certain was filed in accordance with the wishes of the State of Missouri.

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[fol. 359-365] Exhibits Nos. 16 and 16-A Filed

Mr. Schurr:

Q. Mr. McNulty, I show you Exhibit No. 16 and Exhibit No. 16-A. Is that the type of report that was sent to the State of Missouri, if you know?

A. That was the regular monthly report form; yes, sir.

Q. And was there any other report sent to the State of Missouri, other than that regular monthly report form?

A. Only on their request.

Q. What type of report would be sent?

A. Well, this was the regular monthly report; unless there was some special information requested by the department, that would be the only report that would be mailed to them.

Q. I see. Now, as to Exhibit No. 8, was there any request from the State of Missouri with reference to a breakdown, as shown on Exhibit No. 8?

A. Not until that particular date; I don't recall any, no.

Q. Was there any on any other date that you know of?

A. Well, I can't recall.

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[fol. 366] Q. Are you familiar with the record of the company in each state in which it operated since you have [fol. 367] been with the company, and as to the fact that in some states the license of the company to do business was revoked or suspended, in other states the license of the company was withdrawn at the request of the company after the states had put some additional conditions on that the company could not meet? Are you familiar with that subject?

A. I am.

Q. What is the situation generally as to the fact that Fidelity either had its license suspended or revoked, or voluntarily withdrawn, in numerous states in which it operated prior to the year 1941?

A. What was the purpose of that?

The Court: What is the situation as to that?

A. Well, we just discontinued the sale of contracts in December, 1940.

Mr. Lauritzen:

Q. I don't think you understand my question.

A. Well, you will have to enlarge on it, then.

Q. Was your license revoked in any state prior to 1941?

A. I cannot say any of them were revoked prior to that time. We withdrew from several states.

Q. Was it suspended in any states prior to 1941?

[fol. 368] A. Yes.

Q. It was? Where?

A. Well, in 1938, or in the early part of 1939, the company was suspended in a good many states.

Q. Can you tell us what they were?

A. I cannot recall definitely the states; I would say most of them.

Q. In most states.

A. Yes.

Q. In Pennsylvania?

A. Pending the litigation of the SEC, and the subsequent court action, yes.

Q. Now, prior to the SEC litigation, had your license been suspended in various states in which you operated?

A. I don't recall any suspension.

Q. Can you tell us in what states the company withdrew prior to the action taken by the SEC?

A. Well, North Dakota, South Dakota, Arkansas, Oklahoma, Florida.

Q. Can you tell us the reason for those withdrawals?

A. Yes, it was due mostly to economic conditions and the sales program was not developed sufficiently to make it worth while to maintain registration in those states.

[fol. 369] Q. With reference to the state of North Carolina, what was the situation there?

A. As I recall it, an application was made to the State of North Carolina, and then it was later withdrawn.

Q. But you did some business there?

A. I think we were qualified there for a period of time, yes.

Q. Mr. McNulty, did you have in the files of the company over which you had active supervision, a complete record of all your correspondence relating to the status of your license in each state in which you have operated during the course of the career of the company?

A. Yes.

Q. Could you get those for us if we had to have them?

A. They could be obtained, yes.

Q. They are up at the Wheeling offices?

A. That is right.

Mr. Lauritzen: We will not ask for them now, your Honor, but it may be they will become pertinent later on.

Q. Mr. McNulty, I am requested to ask you if a copy of the company's annual audit, that was made by the independent public accountants, was mailed to each of the states, from year to year, in which the company did business.

[fol. 370] A. I could not say it was mailed to every state, but I think it was mailed to practically every state. There might have been a few occasions where it was not sent.

Q. You have testified as to who the accountants were, which the company employed, from 1930 to 1940. Did you employ independent accountants prior to 1930?

A. Yes, I think the firm of Ernst & Ernst was employed for several years prior to 1930.

Q. When was the first time the company commenced to employ outside accountants to make audits; or had it always done that?

A. I would say about 1925.

Q. Up to 1925 it made its own audits?

A. Well, at that time, I don't recall, there might have been some few audits before that period; I don't know.

Q. Mr. Reinhardt asked me to ask you what years you were with the company.

A. From August, 1922.

Q. To the close of business?

A. Yes; to date.

Q. Mr. McNulty, do you know whether ever since the inception of the company, and when it began to sell various series of contracts, that in the annual audits, made by out-

[fol. 371] side public accountants, they have made up a balance sheet and an operating statement for each of the separate series of contracts?

A. I don't recall; I would have to refer to the records. In some cases they were made that way, but I could not say definitely.

Q. How long has the company maintained its own books in that fashion?

Mr. Reinhardt: I would like to suggest, in respect to this whole line of questioning, that the witness' answers be confined to a period as to which he has personal knowledge. Mr. Lauritzen brought out that the witness has been with the company since 1922. I assume he has not been a vice president and secretary since 1922, and if in, whatever capacity he was employed in, he had knowledge of these things then I have no objection to his testifying, but if he is testifying to something of which he has no knowledge, I think it ought to be first made clear, or not become part of the record.

The Court: Well, I suppose that will be developed in the witness' answer. Frankly, I don't see the purpose of all this examination as to what happened fifteen years ago in this company.

[fols. 372-373] Mr. Lauritzen: The purpose, your Honor, is that it has been brought out by Mr. Jaegerman's examination, that they maintained these separate accounts, and in fact, in the Haskins & Sells audit, which was introduced, and that there is apparently some theory that each fund stands on its own feet and is a little separate entity all by itself. What I am trying to get at is, how long the company, itself, has been following that theory.

The Court: All right.

Mr. Lauritzen:

Q. Can you tell us that, Mr. McNulty?

A. As far as I can recall, it has always followed that plan.

* * * * * * *

[fols. 374-377] Mr. Lauritzen:

Q. Mr. McNulty, it is a fact, is it not, that on December 31, 1940 Fidelity amended its charter to give it charter powers as a life insurance company under the laws of West Virginia?

A. That is right.

Q. Can you tell us whether, following that action, the company made application in any states other than West Virginia for a license to do business as a life insurance company?

A. No, it did not.

Q. Did they apply in Ohio?

A. No.

Q. Are you positive?

A. I am almost certain on that.

Q. In Tennessee?

A. No.

Q. As far as your knowledge goes, they made no application whatever in any state?

A. Other than West Virginia.

[fol. 378] Mr. Palmer: Reading from the by-laws as furnished me:

"Section 6. The number of directors of the Association shall consist of not more than eighteen stockholders, any seven of whom shall constitute a quorum. The directors shall hold office for the term of one year and until their successors are elected and qualified."

We now ask to introduce in evidence this copy, subject to any correction as to the number which may be necessary, if an amendment is shown in the annual meeting in Feb-
[fol. 379] ruary, 1941.

Mr. Fleming: The debtor objects, unless the entire by-laws are introduced in evidence.

Mr. Palmer: We have no objection to introducing the whole by-laws, but we did not want to encumber the record except with the necessary portion.

Mr. Fleming: It is not encumbering the record at all.

The Court: Well, let the whole by-laws be introduced in evidence.

Mr. Fleming: The debtor now offers to introduce in evidence, and read as an exhibit, the by-laws of Fidelity Investment Association.

The Court: All right, it will be received as an exhibit.

Exhibit No. 17 Filed

Mr. Palmer:

Q. Mr. McNulty, at the meeting in February, was there any approval in writing of any absent directors?

A. Well, I don't recall any. I retired from the meeting.

Q. Up until the time you had retired, had there been presented to you as secretary any approval in writing of the election of a director to fill the remainder of a term?

[fols. 380-388] A. No.

The Court: He testified there were only two other directors.

Mr. Palmer: I think that is correct, your Honor.

Mr. Fleming: I think in the interest of time, we might save this question for argument, unless there is some factual information sought to be brought out, out-side of the by-laws, themselves.

Mr. Palmer: I want to bring out factual matters, and the only reason I am referring to these by-laws is so the Court may understand what is in them.

The Court: Go ahead.

Mr. Palmer:

Q. Mr. McNulty, perhaps this is repetition, but is it not true that while you were there Mr. Fleming was, at his own express request, elected only for the term of that meeting to fill the remainder of the term of the director whom he was succeeding?

A. I don't recall the exact conditions surrounding that, but that was the understanding.

Q. Wasn't that in substance what was expressed by Mr. Fleming, that he would serve only at that one meeting?

A. Yes.

. . . . . .

[fol. 389] Mr. Fleming:

Q. Now, the securities concerning which you have testified that were deposited in the State of West Virginia, under the state law requiring the deposit of securities, where were those securities situate on the 6th day of June, 1941?

A. They were held by the State Treasurer of West Vir-

[fol. 390] ginia.

Q. And where?

A. At Charleston, West Virginia.

Mr. Fleming: The debtor now will offer in evidence the certified copy of the articles of incorporation of Fidelity, to-

gether with all amendments thereto, as debtor's Exhibit No. 20.

Mr. Lauritzen: Can you identify them in some way?

Mr. Fleming: They are certified to by the Secretary of State.

Mr. Lauritzen: Oh, this is a certified copy?

Mr. Fleming: Yes.

The Court: The exhibit will be admitted without any further identification.

Exhibit No. 20 Filed

Mr. Fleming: Your Honor, I now ask that the bill of complaint in the state court proceedings be admitted in evidence, as Exhibit No. 21.

The Court: All right; that will be admitted.

Exhibit No. 21 Filed

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[fol. 391] Mr. Palmer:

Q. Mr. McNulty, is it not a fact that when these proceedings were instituted in this Court, the newspapers in the City of Wheeling carried front-page head-lines concerning it?

Mr. Fleming: The debtor objects, your Honor.

[fol. 392] The Court: Overruled.

(Exception.)

A. Yes.

Mr. Palmer:

Q. And isn't it a fact that there were front-page editorials in the newspapers in the City of Wheeling, concerning it?

A. There were editorials and front-page articles on it, yes.

Q. Is it not a fact that there were, through the newspapers, organized large meetings, or a large meeting of contract holders?

A. Yes.

Mr. T. C. Townsend: Do you state that as a fact?

Mr. Palmer:

Q. I believe you attended that meeting?
A. No, I didn't.

Mr. T. C. Townsend: Do you state that as a fact, Mr. Palmer?

Mr. Palmer: Yes, I can show you the newspaper clippings.

Mr. T. C. Townsend: You are stating that the newspapers organized these contract holders?

Mr. Fleming: Your Honor, I don't feel that this is at all relevant.

Mr. T. C. Townsend: I just wanted to know that. By [fol. 393] your question you assert that to be a fact. Do you mean that?

Mr. Palmer: I can show you the clippings.

Mr. T. C. Townsend: You assert by your question that the newspapers, by their activities in the circulation of head-lined articles or editorials, were promoting the organization of contract-holders' committees; is that right?

Mr. Palmer: Oh, no, I am not accusing any one of promoting it at all.

Mr. T. C. Townsend: That is what your question implied. I just wanted to know if you meant it.

Mr. Palmer: I did not mean it that way.

Mr. Fleming: This would certainly carry us quite far afield if we are required to meet it, I think. I think the latitude of evidence in this case should be quite broad, but I hardly believe it should be that broad.

Mr. Palmer: In answer to that, you asked Mr. McNulty concerning letters of contract holders and the general tone of those letters. We are attempting to show the same general tone of the contract holders, as demonstrated by the newspapers and by the contract holders, themselves, in the City of Wheeling, the home office.

The Court: Now, Mr. Palmer, I am going to confine that [fol. 394] in this way: if you will show that these demonstrations were directed against any attempt to reorganize this company, then I will permit the evidence to go in; but if it was simply a protest against the particular court in which the proceeding was to be brought, I don't think that has any relevancy here.

Mr. Palmer: I believe, your Honor, I can show that at the meeting which was held of the contract holders—that the purpose of that meeting was to ask for liquidation, and that pursuant to that, Mr. Wood filed, on behalf of some of those contract holders, an answer which asked for liquidation.

The Court: That is proved by the record, is it not?

Mr. Palmer: That is true.

The Court: Then, why bring it into the evidence?

Mr. Palmer: I wanted to have Mr. McNulty testify if he knew of the meeting of the contract holders, pursuant to the notice published in the newspapers.

The Court: Unless you have evidence of other protests than those that joined with Mr. Wood, then I think the record sufficiently shows that without the necessity of any testimony on that.

Mr. Palmer: The record does not show all the people [fol. 395] who attended this meeting. Mr. Wood only picked out, I believe—and so informed the Court—certain representative ones of those groups, rather than put them all in as parties to this proceeding.

The Court: Doesn't his pleading set up the approximate number he represents?

Mr. Palmer: I am not certain.

Mr. T. C. Townsend: Yes, it does.

Mr. Reinhardt: If your Honor please, if any point is to be made of Mr. Wood's attitude about this thing, it should be done while Mr. Wood is here. Unfortunately that is not the case now, as he has left. I do not know why he is not here, but I think the record should show that Mr. Wood is not present at this time.

Mr. Schurr: Well, he had a right to be here. He was here.

Mr. Palmer: Your Honor, he had something to attend to in Wheeling, which made it imperative that he leave.

Mr. Reinhardt: I am not saying this in criticism of anybody, of course, but I think his absence should be noted in the record.

The Court: Mr. Wood had to leave and he explained his absence to me. I am going to adhere to what I have just [fol. 396] said, that if the pleadings filed by Mr. Wood indicate the approximate number of contract holders he represents, then I hold that that sufficiently gets it into

this record, and testimony on that from this witness is not material.

Mr. Palmer: May we check that to see about that, your Honor?

The Court: Certainly.

Mr. Palmer: It names certain persons and says "on behalf of themselves and other persons similarly situated", which, of course, is a general allegation.

The Court: If you can find out from this witness approximately how many people were joining in that petition, I will permit you to do that, in order to simplify the record.

Mr. Palmer:

Q. Do you know of your own knowledge, Mr. McNulty, that there has been a creditors' committee of three leading bankers of Wheeling formed?

A. Yes, I have seen that in the newspaper.

Q. And do you know approximately how many persons signed the petition of that contract-holders' committee?

A. I do not.

Q. May I ask this: were you present at the meeting that [fol. 397] was held, the original meeting?

A. I was not.

Q. Is it not true that when the state court proceedings were instituted, and up until the institution of the proceedings in this suit, there were no such protest meetings, or meetings of any kind of contract holders, to your knowledge?

Mr. Fleming: I object as irrelevant.

Mr. Reinhardt: I ask that the word "protest" be stricken from that question.

Mr. Palmer: That may be done. It should not have been used.

A. Well, I don't know of any meeting.

Q. To your knowledge there were none, and you did not hear of or see anything in the newspapers about any meetings of creditors held, to interest themselves in that state court proceeding; is that correct?

A. That is true.

Q. By creditors I mean, of course, contract holders.

A. Yes.

The Court:

Q. As far as you know about these meetings of the creditors, and the editorials and articles you saw in the papers and so forth, was the objection directed to the reorganiza-
[fol. 398] tion of the company or directed to the court in which the reorganization proceedings were being brought?

A. Well, from the newspaper articles, it just seemed to be a general protest in principal against—it seemed to me to be against Mr. Messick and the set-up.

Mr. T. C. Townsend:

Q. What was that, I can't you?

A. I think from what I saw in the newspaper articles, and so on, the main purpose of the protest was this A. G. Messick set-up. That is the impression I got from the newspapers; I don't think they criticized the Trustee, as far as I know.

The Court:

Q. They just did not want Mr. Messick to have any connection with it; is that it?

A. That was my impression of the newspaper articles.

The Court: Is that all with this witness?

Mr. Palmer: That is all I have, yes, your Honor.

By Mr. Farmer:

Q. The minutes of the meeting of June 3, 1941, recite that pursuant to a notice dated May 27, 1941, a special meeting was held. Did you send out that notice, mail it out?

A. I did not; no, sir.

[fol. 399] Q. You sent no notice of that meeting?

A. No, sir.

Q. Then, do you know, of your own knowledge, that a notice was given to all of the fourteen directors of the company that were named in this meeting—the last meeting when they elected the directors?

Mr. Fleming: To this the debtor objects, for the reason that the evidence shows there were only eight directors serving at the time this meeting was called.

The Court: Sustained as to the fourteen directors.

(Exception.)

Mr. Farmer:

Q. How did it happen that just eight were serving?

The Court: He said the others refused to qualify.

Mr. Palmer: In fairness to the Court. I have copies of those newspaper articles I referred to, and I believe I should produce them for the information of the Court. If the Court deems they are relevant, they can go in; if not, I will not introduce them in evidence. However, I think in fairness I should let the Court see them.

The Court: Well, just have them brought to my desk. It is now after twelve and you can take that up later.

Mr. Palmer: All right, your Honor.

[fols. 400-401] Mr. Palmer: If the Court please, I want to ask the witness to file a copy of the minutes of the special meeting of stockholders held January 24, 1941, which includes the notice of that special meeting. I may say that my purpose in offering that is to show that the company was undertaking to do business as an insurance company; that notice shows all that, and that they were qualified to do business in West Virginia, and were trying to readjust the capital stock for that purpose.

The Court: Are you asking the witness a question?

Mr. Farmer: I am just asking to file those minutes, which I think speak for themselves.

The Court: They are already in, I believe.

Mr. Farmer: Has the whole book been filed?

Mr. Fleming: It is filed under the general order.

The Court: You can refer to any particular part of the minutes contained in the book that you wish to.

Mr. Farmer: This is the part I wish to use, and I would like to file the minutes of the meeting of January 24, 1941, if the Court please.

The Court: All right.

Exhibit No. 22 filed.

* * * * * * *

[fol. 402] FRANK J. MCNULTY thereupon resumed the stand for further recross-examination, and testified as follows:

Mr. Jaegerman:

Q. Mr. McNulty, at the end of 1940 it became apparent, did it not, to the officers and directors of Fidelity Assurance Association that some reorganization was essential?

A. I think that is a fair assumption, yes.

Q. At the end of 1940 it was necessary for Fidelity to register with the Securities and Exchange Commission by filing a notification of registration under the Investment Company Act of 1940?

A. Yes, sir.

Q. And this registration was as a face amount certificate company as described in that law?

A. Yes, sir.

Q. Under that law it would be impossible for Fidelity Investment Association to issue its face amount certificates after January 1, 1941, in the form in which they had previously been offered and sold?

A. That is right.

Q. Furthermore, under the then financial condition of the company it would be impossible to comply with the requirements of the Investment Company Act insofar as the issu-
[fol. 403] ance of a new series of face amount certificates was concerned?

A. I would say that was essentially true.

Q. And that was the concensus of the opinion of the officers and directors of Fidelity?

A. Yes, sir.

Q. Was it not decided at about that time that some step would have to be taken to freeze the status quo until reorganization could be effected?

A. I think that is a fair assumption. They felt some method or plan would have to be devised.

Q. And what were the immediate steps taken?

A. Well, there were several plans considered and developed which were referred to the Securities and Exchange Commission for their advice and approval.

Q. And to what other agency in West Virginia?

A. I don't know, I am not positive as to whether the Insurance Department of West Virginia had seen these particular plans or not.

Q. Well, more particularly the plans were developed with the Securities and Exchange Commission in Washington in mind; however, the office of the Auditor of the State of West Virvinia would be vitally interested in any plan of reorganization that might be effected, would it not?

[fol. 404] A. Oh, absolutely, yes, sir.

Q. And the officers and directors of Fidelity were told that by representatives of the SEC, were they not?

A. Yes.

Q. And joint conferences were arranged with the SEC and the office of the Auditor of the State of West Virginia?

A. I am not familiar with that.

Q. And you attended those conferences in Washington, did you not?

A. Yes, that is right.

Q. Did you say you were not familiar with those joint conferences?

A. No, as to the arrangements. There was a conference in Washington with the SEC and the Auditor and their representatives.

Q. And certain officers and directors of Fidelity Investment Association?

A. That is right.

Q. And along with the proposed reorganization several alternative methods were discussed?

A. That is right.

Q. One was a possible issuance of an insurance policy or insurance contract, and another was face amount investment [fol. 405] certificates or annuity contracts similar to the kind that had been issued by Fidelity Investment Association?

A. They were similar in some respects.

Q. Because the officers and directors of Fidelity felt that their good will or their ownership of certain property rights and their customers were valuable from the history they had developed as an investment company offering an annuity contract?

A. I think that is a correct assumption.

Mr. Lauritzen: I think Mr. Jaegerman is doing most of the testifying. I think there should be some restriction of leading questions.

The Court: The Court is not going to pay any attention to objections to leading questions; overruled. (Exception.)

Mr. Jaegerman:

Q. Is it not true, Mr. McNulty, that the charter of the association was changed so as to give the company the power to issue insurance contracts?

A. That is right.

Q. Is it not true a temporary license was obtained from the Auditor's office of thte State of West Virginia?

A. That is right.

Q. Is it not also true there was a gentlemen's agreement entered with the Auditor of West Virginia that no insur-[fol. 406] ance policies or contracts would be issued?

A. That is right, yes.

Q. Were any insurance contracts or policies issued at any time by Fidelity Investment Association?

A. No, sir.

Q. Did not this temporary license expire at the end of the first four months of 1941; three or four months?

A. April 1, I think it expired.

Q. April 1, 1941?

A. That is right.

Q. Has any license been issued thereafter?

A. No, sir.

Q. What was the business of Fidelity Investment Association from January 1, 1941, to April 11, 1941?

A. Well, it was purely the servicing of the contracts already on our books.

Q. And what kind of contracts were they?

A. They were the income reserve installment savings contracts.

Q. The face amount certificates according to your registration with the SEC?

A. That is right.

Q. And from the period December 9, 1940, to December [fol. 407] 31, 1940, what kind of certificates were issued and sold by Fidelity Investment Association?

A. What is commonly called the face amount certificate.

Q. Which is the same type, the same identical certificate that was issued prior to December 9, 1940 by Fidelity?

A. That is right.

Q. I have been asked to ask you this question: At or about April 1, 1941, was a license issued to Fidelity Investment Association by the Auditor's office of the State of West Virginia authorizing or permitting it to issue insurance contracts for a period of one year?

A. April 1, 1941?

Q. Yes.

A. Not to my knowledge.

Q. Expiring March 31, 1942.

A. Not to my knowledge.

Q. You have no knowledge of any such licenses?

A. No, sir.

Q. You have no knowledge of any renewal of a temporary insurance license?

A. No, sir.

Q. And you were Secretary and Vice President of the company, were you not?

[fol. 408] A. That is right.

Q. As of April 10, 1941, how many active contracts approximately did Fidelity Investment Association have on its books?

A. Well, approximately I would say between twenty-two and twenty-five thousand active.

Q. And what do you mean by active contracts?

A. Well, the ones that were continuing with the regular monthly payments.

Q. And had not been in default for a year, which I think is the default period contained in the contracts, which speak for themselves, being an exhibit?

A. Yes.

Q. Then what action was taken April 11, 1941, either by or against the company?

A. The appointment of the state receivers by the state court.

Q. And was not this appointment the result of the failure of the company to effect a reasonable plan for voluntary reorganization under the appropriate section of the Investment Company Act of 1940?

Mr. Palmer: I object. That suit was brought by the Auditor of the State of West Virginia under his statutory [fol. 409] powers and was not the result of any action on the part of the company, but an act on the part of a state officer.

The Court: Overruled. (Exception.)

A. Well, I would assume that that had a direct bearing on that.

Mr. Palmer: I object to the assumption of the witness.

The Court: Strike out the assumption. If you have any knowledge you may answer.

Mr. Jaegerman:

Q. Don't you have any knowledge on that question, Mr. McNulty?

A. Well, I feel that that was——

Mr. Palmer: Objection on the same ground.

The Court: Yes, that is just answering it in another way to the same effect.

Mr. Jaegerman:

Q. Were not you present at various conferences between representatives of the SEC and the company and the Auditor's office where possible plans for reorganization were discussed in the event of failure of a voluntary plan for reorganization under the appropriate section of the Investment Company Act of 1940?

A. Yes, sir.

Q. And was not one of those plans mentioned an action to be brought by the Auditor of the State of West Virginia? [fol. 410] A. Yes, sir.

Q. And was not the Fidelity Investment Association fully aware that this question was discussed or this action contemplated and would be brought by the Auditor's office of the State of West Virginia.

A. I think so, yes.

Q. If a plan for voluntary reorganization was not consummated under the Investment Company Act, that is?

A. Yes.

Q. And the Fidelity Investment Association saw the actual court papers that had been prepared by the Auditor's office of West Virginia before they were actually filed, did it not?

A. Yes. Well, now, I could not say. I did not see them. I don't know whether the attorneys saw them or not.

Q. Mr. McNulty, how many active contracts are there presently on the books of Fidelity Investment Association?

A. The ones that are actively making payments at this time?

Q. You testified as to the number of active contracts on April 10, 1941. Now will you please give an approximation of the number of contracts which have continued to make payments from April 10 to date?

[fols. 411-412] A. I would say approximately ten or twelve thousand.

Q. Which would be approximately 50% of the total that had been active on April 10, 1941?

A. That would be my idea.

Q. And these continued payments were made in spite of full disclosure of the various court actions that have been

brought against Fidelity Investment Association or by the debtor?

Mr. Gray: We object to the argument in the question.

The Court: Overruled.

(Exception.)

A. Yes, those payments were continued.

. . . . . .

[fol. 413] Mr. Jaegerman:

Q. Mr. McNulty, the inter-fund loans and the overdrafts were all fully reflected on the books of the company, were they not?

A. Yes, sir.

Q. Furthermore, they were set forth in the detailed audit reports of Wilson & Meredith, and Wilson & Cross, were they not?

A. I am sure they were, yes, sir.

Q. And the report of Haskins & Sells?

A. Yes, sir.

Mr. Lauritzen: I don't think the witness knows whether Haskins & Sells or Wilson & Meredith properly performed their work or not. I assume they did but I don't think he can testify to that.

Mr. Jaegerman: This witness is Vice President and Secretary of the company. These audits were furnished him. He is competent to examine them and say whether they reflect these inter-fund loans and overdrafts.

The Court: The objection is overruled.

(Exception.)

Mr. Jaegerman:

Q. Mr. McNulty, were not these detailed year-end audit reports furnished every state official where Fidelity was [fol. 414-418] doing business?

A. I can't answer that for a certainty. I know provision was made in the preparation of a sufficient number of copies to furnish one to each state.

. . . . . .

[fol. 419] Thereupon, JOHN MARSHALL, SR., having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name to the Court please.
A. John Marshall, Sr.
Q. Where do you live, Mr. Marshall?
A. Washington, D. C.
Q. What is your profession?
A. Attorney.

[fol. 420] Q. Have you occupied some official position with the Fidelity Investment or the Fidelity Assurance Association?

A. I have been a director of Fidelity Assurance Association for approximately 20 years, and have been chairman of the board for several years.

Q. And you have been a stockholder also?

A. I have been a stockholder even longer than I have been a director, yes.

Q. At the present time what is your official connection or relationship with Fidelity?

A. I am a director and trustee for certain stockholders who deposited their stock, and my firm is general counsel for Fidelity, Marshall & Forrer, with offices in Parkersburg and Washington.

Q. Do you have knowledge of the filing of the receivership proceeding in the Circuit Court of Kanawha County, West Virginia, early in April, 1941?

A. I attended a directors' meeting at which it was developed that such action was probable, and participated in the discussion and action of that meeting.

Q. You might tell the Court, if you will, what the purpose of that proceeding was and what motivated the company, if there was a motive by the company, to have that action [fol. 421] taken.

A. I was not active either in the conversations with the State Auditor's office or the Securities and Exchange Commission, but I understood from those officers and attorneys who were there that no plan of reorganization was deemed practical unless it had the umbrella of a court proceeding, and that the Auditor, having been advised of that deter-

mination, indicated that he proposed then to institute this proceeding.

Q. Now, after that proceeding was instituted, and after receivers were appointed, what participation if any was had by Fidelity in an effort to develop a reorganization in that proceeding?

A. Well, at the meeting at which the directors were advised of this possible proceeding in the state court, all the directors, I might say, feeling that a plan of reorganization could be worked out, in their opinions, undertook to form a committee to formulate a plan, or try to develop a plan, of which Mr. Allan G. Messick was made chairman with authority to select his associates.

Q. How long did that continue?

A. Well, it continued up until the time of the Pittsburgh meeting, I should say.

[fol. 422] Q. Then you may briefly explain, if you will, what the situation was with Fidelity at that time and what led to the filing of this proceeding in this court.

A. Well, I might say that when these by-laws that have been introduced in evidence were adopted, Fidelity, I think had 17 directors. I think in 1938 the number was 17. I believe perhaps in other years it had been even higher. At the last annual meeting of the stockholders an effort was made to fill vacancies and enlarge the board, re-electing practically all of the then directors and I think that perhaps seven additional directors were elected, six or seven. I particularly was interested in that effort, because I was trying to bring back on the board some men who I thought had been valuable to the company, notably, Mr. Koontz, who, while not serving as a director in the interim had been serving as attorney and counsel, and Mr. Grosscup of Philadelphia; and then other names were suggested likewise—a Wheeling man whose father had been a director, a valuable director of Fidelity, whose name I don't just recall now; but by the time of the Pittsburgh meeting none of those men had accepted. As a matter of fact, Mr. Foulk had resigned, so it left only eight directors of the association when we had our Pittsburgh meeting.

[fol. 423] Q. Now, particularly what was the situation in reference to the Fidelity Assurance Association insofar as its business affairs were concerned at that time?

A. Well, we were then under the state receivership, and the only business we had, as has been testified here, was the

keeping in escrow of the accounts of the payments that were coming in; but Fidelity was undertaking no other activity.

Q. If there were any outside state receiverships which had developed in the meantime, tell us about that.

A. Well, it was reported at that meeting that a number of states had—that there had been applications and appointments in some instances made of state receivers; that in some states even two applications were pending; that there had been a meeting of a number of insurance commissioners or state authorities who had jurisdiction over Fidelity in various states and it was the sense of the meeting that it was an intolerable situation; that no reorganization plan could ever be effectively adopted, no matter how fair it was, if we had to go into all these various jurisdictions, and that there ought to be, just as the act contemplates, one jurisdiction where this plan could be submitted, and I might say also that in addition to those directors who were present—[fol. 424] I understood the purpose of the meeting; we had had five days' notice of it—I had invited Mr. Koontz to be present, and not only invited him but urged him to be present. He called me on the telephone, I think the night before the meeting, and said there was some possibility he could not come. I again urged him: told him I thought it was a very critical time for Fidelity and that I thought we needed his advice and counsel. I also invited Mr. Austin V. Wood, who had acted as attorney for Fidelity in the receivership proceedings before Judge Baker, and he wired that another engagement prevented him from attending that meeting.

After hearing of these various situations I thought it was the unanimous action of the board—I notice the minutes say Mr. King refrained from voting but he certainly expressed himself on that occasion and I remember distinctly what he said, and that was that as far as the state receivership operation of the company was concerned, he thought it was very satisfactory and they were doing a good job. I think he so used those very words, but he did not see, with all these proceedings coming out all over the country, how we could ever effect a reorganization plan, which he thought should be done.

Q. Was something said about there being the necessity [fol. 425] of a central authority which could determine the legal questions involved?

A. Precisely.

Q. And that it would be impossible to reorganize without having that situation?

A. That is right. That was developed in the discussion at that time.

Q. Was that primarily the principal reason for the filing of this proceeding?

A. I should say that is a very fair statement.

Q. And the authorization of the proceeding by the board of directors?

A. Yes. I notice the newspaper accounts say, or give the impression anyway, that it was a "packed" meeting. I know I had never discussed the matter with any director before I got there. The directors came in from different parts of the country, into this room, and the discussion was friendly and frank and free, and I heard no other suggestion made by anyone.

Q. There has been something said about the manner in which the resolution was presented or prepared, as to whether or not the resolution was brought in by Mr. Messick or anyone else already prepared and ready for the board to [fol. 426] adopt. What is the fact about that?

A. There was no resolution handed me, I know, and I saw none handed around. As I recall it, you said you had made some notes and if this action was taken you had in mind something about a resolution, and as I recall, in the interim you went out and had that resolution written by the stenographer, dictated it to her; but I am positive no resolutions were passed around and there was no action agreed upon or discussed before this meeting, because the very purpose of having Mr. Koontz, whose firm represented the state receiver, and Mr. Wood, who lived in a northern district, was to discuss every phase of the situation.

Q. To refresh your recollection, I will ask you if the notes I made were not made upon stationery——

Interposing:

A. I think upon the back of an envelope, yes, sir.

Q. —of the William Penn Hotel, possibly on the back of an envelope?

A. Yes, I know they were very rough notes.

Q. That was done there in the room where the meeting was held?

A. Yes.

Q. You have said that you have been rather actively [fol. 427] identified with the affairs of Fidelity for the past twenty years?

A. My father-in-law founded the company. I had a sentimental interest in it before I was elected to the board, which was shortly after his death.

Q. Is your paramount interest in this proceeding for the benefit of the stockholders, or for the benefit of the contract holders?

A. I dislike to proclaim my own unselfishness, but I think I can truthfully say I have a perfectly unselfish interest in this situation. It began with my sentimental interest in my father-in-law. I know what his plans were for this institution. I discussed them with him—he talked to me time after time about that. I have been a stockholder and a contract holder, my wife and I, of course, for years. We were paying on nine contracts at one time and I have matured some since. I have simply had faith in the plan and its purpose. I think it does serve a useful purpose despite the criticism which came after the apparent failure, and my sole interest is in a reorganization of this company and its continued usefulness, and I certainly think that it would be definitely to the interests of the contract holders, because I cannot see anything but severe loss by liquidation. Since I came [fol. 428] in the court room I have been thinking about even our Government has loaned hundreds of millions of dollars to the British Government to prevent liquidation of their securities on this market, and I know of specific instances where sales now, if you can predict any trend in the market, would be very much to our disadvantage, in addition to the terrific cost afterward, to the operation.

Q. As I understand, Mr. Marshall, the principal amount of the assets of Fidelity have been invested in securities, the greater portion of them listed securities?

A. That is right.

Q. And the greater portion of them are liquid, as I understand?

A. That is correct.

Q. Are those subject to market fluctuations?

A. Decidedly.

Q. And when the market goes up, why, the value of your assets increase and when it goes down the value of your assets decrease?

A. Yes, I can give you a specific instance within the last few months, when Fidelity needed some cash it was suggested, I think—within this year certainly, just a few months ago—that we sell 20,000 shares of Hartford Rayon [fol. 429] which the general fund owed. Of course, the reserve funds don't buy the type security but this was a special situation, which was investigated principally by Mr. Koontz incidentally, and the company made an extensive purchase of those securities. At that time when the action was contemplated I think the market price was 9/16ths.

Q. Of a dollar?

A. Of a dollar, yes, and I went to my bank and offered to endorse the note for $10,000 rather than see that stock sacrificed. I noticed that quotation this morning. It is 1 3/16ths, or almost double in value since those few months; and I might say incidentally that I did do it, I endorsed the note and got the company the funds without the sale of the stock.

Q. Do you think it is feasible and practical to work out and develop a plan of reorganization in order that the company may continue in active business?

A. I don't want to qualify as an expert on that. I can only say this, that I am persuaded by my experience that there is a need for a company like this; it serves a useful purpose and it is amazing to me how its contract holders have stood by in all these troubles I have referred to. Not a person criticizes me for advising them to take these con- [fol. 430-432] tracts, although I have advised literally hundreds of people. On the contrary, I have had many contract holders even call on long distance and say they believe in Fidelity and want to stick by it. The impressive thing to me is I have never seen anyone who has ever made a study of this situation in our own organization who has not felt it was feasible. I know that has been Mr. Koontz position all these years. I know that at times people have wanted to step in and get control of the company, but everyone I have ever talked to really feel reorganization is practical.

. . . . . .

[fol. 433] Q. Did there come a time when Fidelity amended its charter and endeavored to write insurance along with annuities or face amount contracts?

A. It was contemplated. They never actually did it but it was contemplated.

Q. How did you happen to amend the charter?

A. Well, there were representations made that—I had personal knowledge of some of these facts—that a great many of our salesmen, in interviewing clients with respect to these contracts, would find they were not interested in that but would be interested in insurance; and, as a matter [fol. 434] of fact, a number of our salesmen were licensed insurance agents, and the two activities, just as many insurance companies have, the two would fit in very well, and also that we had developed ourselves quite an insurance business which was then being—the profits or most of the profits of which were then going to another insurance company, that is, the insurance feature in our contracts.

Q. That is the accrued insurance feature?

A. Yes.

Q. And what company was that handled by?

A. The Lincoln National Life.

Q. The Lincoln National Life Insurance Company of Fort Wayne, Indiana?

A. Yes.

Q. I will ask you whether during the entire history of the company Fidelity have ever at any time issued or sold any insurance contracts or policies.

A. Not that I know of.

Q. I will ask you whether or not it is a fact that the only contracts issued or sold by this company during its entire period of existence are these Special Income, Special Annuity and Series A, B, C, and D contracts which have been admitted in evidence and are marked as Exhibits 1 to [fols. 435-436] 5, inclusive; is that right?

A. As far as I know, that is correct.

Q. What directors were present at the Pittsburgh meeting, Mr. Marshall?

A. All directors were present at the meeting in Pittsburgh except Mr. Burt, who sent word he was attending a telephone meeting in Charleston on that day and could not be present, and Mr. Risley, who was gone on a holiday or was at least away from Wheeling. I understand he wired, though I did not see the wire, that he could be there. The other directors were present.

Q. How many were present, not including myself?

A. Six; two were absent.

* * * * * * *

[fol. 437] Q. Can you further explain your statement that there was need for a company and a business of this character, such as followed by Fidelity?

A. I may be prejudiced in that viewpoint, but I have always felt myself the need. I understood from Mr. Paull why he thought there was a need because of his banking experience; that a great many people open savings accounts but did not continue them. I myself had that experience, [fol. 438] but I matured five Fidelity contracts, and I think that has been the experience of a great many people. I understand Fidelity has disbursed to contract holders approximately $44,000,000. Now, that means those people saved that money. It was never my thought that it is a type of savings or investment that anyone could make huge profits of, but it is a practical savings plan; and of course, it is, I suppose, generally understood that we did not encourage cash surrenders or anything else other than a carrying out of the contract. We sent out literature with our notices and if people became delinquent they were notified and urged to keep up their payments. We tried to present a plan and get people to adopt it to save money, and we have done nothing I know of that is inconsistent with that purpose.

Q. What about the provisions of the contracts which permitted the contract holder who had lapsed over a long period of time, two or three years or longer, to renew and start saving again?

A. There was no forfeiture, no advantage taken of that.

Q. And what about the participation——

A. In the surplus?

Q. Participation in the profits?

[fol. 439] A. Well, that was undertaken. I should say that the reason it was abandoned was that a great many salesmen, we found, were overdoing that and leading people to false hopes that they would make profits by participating in the profits of the company, and in effect a misrepresentation; and that was not the theory or the original idea, and I think it does more harm than good; so that was the reason it was abandoned.

Q. What was the original idea, Mr. Marshall?

A. To provide a plan whereby people might save money by putting in small amounts each month, being advised of the date of their payments; to get people to save money consistently in that way, and then the man who could not

invest only $10 a month would, in the aggregate, that would mean an investment in which he would be part owner, and by making only small monthly payments he would be saving against the future.

Mr. Fleming: You may cross-examine.

Cross-examination.

By Mr. Palmer:

Q. About what year was Fidelity started?

A. 1911, I understand.

Q. It was started as a corporation?

A. Yes, sir.

[fol. 440] Q. And capital of how much was paid in?

A. I think only $50,000.

Q. And for that capital stock was issued?

A. Right.

Q. You became a stockholder when?

A. I think I became a stockholder immediately after the first effort was made to declare Fidelity a bankrupt, which is a great many years ago. The suit was instituted but never process taken and a group was formed to buy out the stockholders who were dissatified at that time. Mr. Paull had died and I bought, I think, ten shares of stock.

Q. Approximately what year was that?

A. I should say around 1920. I am not very good at dates.

Q. For the money you and the other stockholders advanced on the capital stock, you expected to make a return on your investment; isn't that right?

A. Well, with that exception when I became interested I never sought to buy stock in Fidelity. All the stock I owned was stock I had taken off somebody's hands that I had gotten interested, for example, in the company, and I would take the stock off their hands because of that.

Q. You expected a return on your money. You were not [fol. 441] financially able to put up money without——

A. (Interposing:) I am not wanting to adorn myself with wings, but I must tell you the President of this company, who served it I think for $50 a month, did not undertake it as a money-making proposition and neither did I.

Q. At the same time you expected sufficient return on your investment that your money—that any money you invested is entitled to?

A. I think I might controvert that also to some extent. I don't think the stock has ever paid over 4%, and I have known it to sell for $300 a share and I think if I simply wanted to make money that is when I would have sold, or when I saw these dark clouds approaching I would have sold, and I never did sell a share.

Q. You still wanted to make a return on the money you had invested?

A. Naturally, but that was not my primary purpose in becoming interested.

Q. As a matter of fact, the company was formulated and largely owned by Joseph Paull, Sr., your father-in-law?

A. Absolutely that is not true.

Q. What is the correct fact about that?

A. Mr. Paull associated four other directors of the Na-
[fol. 442] tional Bank of West Virginia, Mr. Ogilbie of Wheeling, Mr. Russell Hubbard, Mr. Wood and Mr. W. P. Irvine, and each had equal amounts of stock.

Q. At the time of Mr. Paull's death how many shares of stock did he have?

A. Not over 100.

Q. How many were in his wife's name at that time?

A. None.

Q. And what percentage of the company would that 100 shares of stock, his holding, whatever that was, represent?

A. When it was started he was one-fifth owner. I do not know of any change in that situation. I don't think there had been any other additional stock sold, but I would not be positive.

Q. His holdings never became less than one-fifth interest in the company?

A. I am not sure. Certainly his estate holdings did.

Q. What?

A. Certainly the holdings of the Paull estate became less than one-fifth.

Q. I understood you to say, Mr. Marshall, you were a firm believer in a savings plan whereby persons put in money on the installment plan and receive a return on their
[fol. 443] money, and where in time they are paid their money either in a lump sum of periodically over a period of time?

A. I don't think I went into that detail. I said I am a believer in the savings plan. The best proof is that I have had seven contracts and matured five of them.

Q. And I believe you said you thought this company could be reorganized into a practical savings plan?

A. I have said that was the opinion of all persons I have known who have made a study of this situation, including the senior partner of your firm, Mr. Palmer.

Q. And I further believe you said that practical savings plan would have to be made with no profit to anyone in it?

A. I don't think I said that. I did not intend to say it. I have not any idea of the plan, have not worked on the plan, and don't feel that I am competent to work on it. I have hoped some plan could be worked out. What I meant to testify was that I was not speaking for myself but that everyone I had known and talked to about this for several years felt it could be accomplished.

Q. My question, Mr. Marshall, is this: on your direct examination did not you say you believed a practical savings plan with no profit to be made on it could be worked out?

[fol. 444] The Court: He says that if he said that he did not mean it, which I think is sufficient answer, with the explanation which he has now made.

Mr. Palmer:

Q. It is not your idea a plan could be worked out where there could be profit made by those who would invest in it as stockholders; is that right?

A. I have no recollection of saying anything about that subject.

Q. I am asking you about it now.

A. I have said distinctly I have no plan in mind. I would not even sit here as a witness and say a plan could be promulgated, but I do repeat that everyone I have talked to who has made a study of it thinks it can be accomplished, with proper cooperation and a little unselfishness all around, and no desire to get into the picture just for the sake of fees, and all that sort of thing.

Q. Just speaking for yourself, Mr. Marshall, and I believe you will have to testify for yourself, do you believe a practical plan of savings can be worked out of this present company?

A. A practical plan of savings?

Q. Yes, a practical plan for savers to invest—whether it can be worked out of this company, Fidelity.

[fol. 445] A. I don't understand you. There are other institutions prosecuting a plan almost similar to Fidelity, successfully, if that is what you mean.

Q. No, my question is, do you believe a plan can be worked out of this company.

A. I can only repeat, others who have made a study of it say it can be.

Mr. Palmer: I will have to refuse his answer, your Honor, and ask that he answer my question as to whether he believes it.

Mr. Farmer: I object to the witness undertaking to say what others say.

The Court: Overruled, but the witness is required to answer what he himself believes, if he has any opinion about it.

The Witness: I simply have this opinion, Judge, that I myself, because I don't feel I am qualified to undertake to testify about a plan, cannot say personally, but from my study and conversations with others who, I think, are competent, and who have in turn talked with authorities who have made studies of this and similar situations, believe it can be done, and I fervently hope it will be.

Mr. Palmer: The part of the answer where the witness [fol. 446] says he has talked to others, is objected to and I move that it be stricken out, leaving only the first part as to his own opinion.

The Court: Overruled. (Exception.)

Mr. Fleming: May I ask if from investigation he has made recently, and his experience with the company and with its program and its business covering a long period of years, he believes that a plan can be successfully developed?

The Court: Yes.

The Witness: I think that it can be, and I think if it can be developed so that the company can begin operations again there is just the same necessity and the same opportunity to prosecute it successfully.

Mr. Palmer:

Q. Mr. Marshall, do you think such a company can make a profit to stockholders who invest money into the formation of such company, or persons who would put up the

capital, that they could make a profit on the capital they put up to form such company, in your opinion?

A. That would depend, of course, on the management and many other factors. Of course, the fact that I have not made any might be due to a good many reasons. I personally think the great difficulties Fidelity has encountered has nothing to do with the soundness of the plan, but there were [fols. 447-452] forces and conditions over which they had no control. We have gone through two or three panics and a war in the short history of this company, and I think that has reflected more on it than anything else.

Q. My question is whether or not you think a company can be formed whereby the persons who invest in that company, in the stock of that company, or put up the money for the capital structure of it, can make a profit or return on their money.

A. That will have to be developed—I don't see what value my opinion will have on that anyway.

Mr. Fleming: I think he has answered that, because he said it depended on the management.

The Court: I think he has answered it as fully as he can, Mr. Palmer.

Mr. Palmer: May I have a yes or no answer to the question, if he can answer it yes or no?

The Court: I hold it has been answered as far as the witness can be expected to answer it.

[fol. 453] Mr. Palmer:

Q. Is it your opinion, and was it the opinion of the board of directors, that after the investment company act of 1940 took effect on January 1, 1941, it was impossible for your company to comply with the requirements of that act?

A. I understand it was, unless we could secure additional capital.

Q. So that therefore any reorganization that was contemplated, and which could take effect, was expected to take effect as an insurance company; isn't that right?

Mr. Fleming: The debtor objects.

The Court: Overruled. (Exception.)

A. Oh, no, that was only one of the various efforts—that happened to be the last. We undertook to work out this situation in a number of ways but were never successful in doing it, that is all.

Mr. Palmer:

Q. That is my point, Mr. Marshall, and that the only way it apparently could be successfully worked out was the way which you last attempted, by amending your charter and to work it out as an insurance company.

A. I say, that is one of the things we tried and that did [fol. 454] not work either.

Q. And it was your understanding that that was the way the Auditor was going to attempt to work it out in a state court suit, was it not?

A. I never have had a conversation with the Auditor about that particular matter. I have often talked to him about Fidelity matters. He has been very keenly interested in our company, as it was his duty to be, and he has talked to me about various phases of the company, but never that.

Q. Mr. Marshall, would it not be fair to say your company tried every other way other than an insurance company, and was unable to reorganize?

A. I wouldn't say we tried every other way. We had a committee first, before Mr. Messick was chairman, that I served on too, and your senior partner was the leading figure in that committee, and Mr. Grosscup and other directors, and we undertook to work out various plans and I think some of them were found impractical for one reason or another.

Q. You sincerely and earnestly tried to work out various plans which would be successful, isn't that right?

A. Of course, that mostly involved getting capital and——

Q. And this occurred within the last three or four years?

A. Yes, after our initial difficulty with the Securities and [fol. 455] Exchange Commission.

Q. And your last attempt was as an insurance company?

A. That is right.

Q. That had no change in that you never attempted to sell anything under it; is that right?

A. It just did not work out as it was blueprinted.

Q. After the first of the year the Securities and Exchange Commission would not let you go on any further; is that right, under any plans you had formulated?

A. As I understand, and again I repeat, I did not have the conversations but I understand, from almost the initial difficulty with the SEC they have shown a willingness to sit

down and talk our problems out and these conversations have been going on from time to time ever since. We have never felt that the SEC was showing any antagonism to us but rather a willingness to cooperate. Now again, as I say, I have never had the conversations but that is the attitude reported to me but of course under their responsibility they can make only certain accords; they cannot go beyond their province.

Q. They can only permit you to do what the law which Congress passes allows; is that correct?

A. Yes, sir.

Q. And they advised your company that under its then [fols. 456-457] set-up it would not be allowed to go on and do what it had been doing?

A. Well, I am again only repeating information which you are in position to give more accurately even than I, because you see the gentlemen more frequently than I do, but I understand that it was the position of the Commission that no sort of reorganization plan could be effected unless it had the protection of a court.

. . . . . .

[fol. 458] Q. Can you answer this question as to what rights of the contract holders needed to be modified so that the earnings received on securities and assets owned by the debtor will be sufficient in amount to meet the requirements under its outstanding contracts?

Mr. Fleming: I object.

The Court: This witness has already answered that in his other answer, it seems to me. He says he doesn't know anything about that.

Mr. Palmer: If that other answer covers it I will be glad to accept it, your Honor.

A. I only know of them; I don't want to claim complete ignorance. As I understand it, our difficulty is in deficiency in some of these funds, and not the fact that we could not operate a business successfully on our present contracts. As I recall, within the last few years we have taken profits largely out of stock sales transactions and put into these accounts to the amount of about one and a half million dollars. If we had sufficient time to continue that operation with the same success, and were permitted by the authorities, we might do it, but the difficulty about a situation

like that is that these contracts are maturing and have to be paid now or next month. Whether some plan can be [fols. 459-460] worked out, again I say, I am not qualified to say.

. . . . . .

[fol. 461] By Mr. Lauritzen:

Q. How long had yourself and the other officers of the company known a situation existed which would call for some readjustment or reorganization of the company? How long have you recognized the existence of such a situation?

A. I should say it only became apparent after our dif- [fols. 462-464] ficulties began in the various court proceedings.

Q. Do you refer to the SEC proceedings that took place in——

A. I don't mean that the SEC proceeding was the controlling factor, but that was closely followed by the receivership proceeding which caused a cessation all over the country for months, and these various things have also entailed very heavy expenses. I think, without any reflection on anybody, that that was the first time that it became apparent there was something else had to be done.

. . . . . .

[fol. 465] Q. From the period 1930 on, during which time I believe it has been testified that overdrafts existed in the various funds, did not the company pay dividends to its officers or to its stockholders, and did not you as a stockholder receive dividends?

A. The company has a very unenviable common stock dividend record, what years they paid and what years they did not, I know they never paid dividends unless counsel [fol. 466-467] and the officers said they were authorized to pay it out of earned profits.

Q. Did they pay dividends during the three years in which you were chairman of the board?

A. I can't remember.

Q. Can you check that, or who can give us that information?

A. I should think Mr. McNulty, but I had nothing to do with the recommendation of dividends, if that is what you want to know.

Q. Nothing to do with the recommendation?

A. No.

Q. Would not the board of directors declare the dividends?

A. Always, on recommendation of the president or other officers.

Q. But the authorizing action was on the part of the board?

A. The board had to approve it, yes.

Q. And to your knowledge there were dividends paid during the period in which overdrafts in the various funds existed; is that correct?

A. I think so.

. . . . . .

[fol. 468] By Mr. Farmer:

Q. Mr. Marshall, if the averments in debtor's petition showing that there is a deficit of approximately $2,600,000 in these reserves on these outstanding contracts is a true and correct statement of the debtor's condition, would you not say, in order for the company to be reorganized it would be necessary to cover that deficit in some way in the plan of reorganization?

A. Well, certainly something has to be done about it.

Q. Now, do you know or have you any idea of any way in which that could be done?

Mr. Fleming: I object. That is the same question that has been gone into.

The Court: Mr. Farmer, it seems to me that does not [fol. 469] have anything to do with the feasibility of a plan, because in the event of liquidation the deficit certainly could not be covered. In the event of reorganization probably the deficit could not be covered either; but the deficit is there and your question is would not it be necessary to do something to cover that deficit. I do not think that has anything to do with the feasibility of the plan.

Mr. Farber: It has this Your Honor: the witness, who has a high official position with the company and has had over many years, and who is presumed to have some knowledge about the company's affairs, has taken the stand for the debtor in aid of this proceeding. It seems to me he ought to be able to shed some light on this question that

the Court is confronted with. The witness admits the deficit would have to be covered in order for the company to reorganize and operate successfully. In other words, a reorganized company——

The Court: No, he did not say that. He said something would have to be done about it.

Mr. Farmer: Unless there is some way we can cover that deficit then how can we have a plan of reorganization, and how could it be said there is a reasonable prospect of reorganization?

[fol. 470] The Court: I don't think anybody is going to create two and a half million dollars out of nothing.

Mr. Reinhardt: Along those lines, your Honor, I would like to reiterate something I said early in this hearing, the applicability of which perhaps was not as apparent then as it becomes now, and that is one of the things provided for by Chapter 10 is a report by the Trustee as to the conduct of the debtor's affairs, and as to what facilities exist and what materials exist for a reorganization. Now, before any such report is submitted nobody is in a position to form any opinion as to whether a particular kind of reorganization plan can be worked out or not. The most that can be determined at this preliminary stage of the proceedings is whether there is a reasonable prospect that something along those lines can be done, and I think that is the full extent to which the law requires your Honor to go in connection with the issues raised on the question of jurisdiction, and if your Honor finds there is such a reasonable prospect on the basis of the information made available here, then that aspect of the jurisdictional question will be decided in that way, and otherwise to the contrary, but all this testimony and arguments as to a particular kind of plan, or the particular assets or materials which [fol. 471] are available for a plan of reorganization just "jumps the gun" on the procedure contemplated by the act, if the Court please.

Mr. Farmer: The courts have held it is the duty of a district judge, when a petition is filed by a debtor such as in this case, to first determine he has jurisdiction; and the debtor carries the burden of proving that there is a reasonable prospect of reorganization. The courts have held repeatedly that that reasonable prospect must be

something more than just a forlorn hope, as the Circuit Court of Appeals from this circuit has said in a recent case; something more than just an emotion, dream, phantasy or hope of those who have been connected with the company and who would like to see it go on. We know it is not to be expected that they would come here with a blueprint of the plan, filling out all of the details and the number of joints, cross-sections and everything of that kind; but at least the Court is entitled to an outline of it. We ought to know whether it is going to be a circle or a square or a rectangle or a rhomboid or something else; but they cannot even tell us whether it is going to be an insurance company, face amount certificate company or what. They tell us nothing. It is just a phantasy, and I think we have a right [fol. 472] to cross-examine on these material points, such as covering a great big gap in reserves on these contracts.

The Court: As a matter of fact, you are talking about a plan which Mr. Marshall or the company may have in mind; but the plan that will be presented to this Court, if one is presented, will be from the Trustee, and how is Mr. Marshall going to know anything about any plan the Trustee may be able to formulate later? I am going to restrict your examination to other phases than the kind of plan Mr. Marshall may have in mind. I am going to rule that any questions relative to that are out of order.

Mr. Farmer: Your Honor, I was not asking about the kind of plan but about the essentials any plan must have.

The Court: I think that is equivalent to the same thing. (Exception.)

Mr. Palmer: If the Court please, it is required that the debtor prove good faith, and one of the essentials of proving good faith is that they prove that a plan of reorganization can be effected. I thoroughly agree with the Court that the plan which is ultimately presented will come from the Trustee, but in order to substantiate the ground of good faith, which is controverted in practically all these bills, the debtor must show that it is reasonable to expect that [fol. 473] a plan can be effected.

The Court: Yes, but in showing that, if all the facts which are shown are such that the Court can determine that there is some reasonable basis for expectation of a plan

being evolved, it is the Court's opinion that it is not necessary that the debtor have such a plan outlined in its own mind.

Mr. Palmer: I think your Honor is correct in that, of course.

The Court: Therefore, I am just going to consider all of these facts that have been presented to me, and determine from the facts and not from some opinion Mr. Marshall may have, or Mr. McNulty may have, but determine from the facts whether it is reasonable to believe a plan of reorganization can be formed.

Mr. Palmer: I had in mind that the only way a plan of reorganization can be effected in the ultimate conclusion is for 66⅔% of every class of creditors to approve of it, and if a deficit of two or two and a half million dollars exists by virtue of which they will be cut down, then this Court should consider that fact as a bearing on whether the contract holders will approve any plan.

The Court: The Court will consider that fact, but the [fol. 474] Court will not consider what Mr. Marshall may think about it.

Mr. Palmer: I think that is right, other than he has expressed an opinion on which he should be cross-examined to a small extent as to his own personal opinion, I believe, your Honor.

Mr. Fleming: He certainly has been cross-examined, I submit.

The Court: His opinion may have some bearing on his good faith.

The Witness: We would not have taken the action in Pittsburgh, Mr. Palmer, if we had not hoped—and it was not a "forlorn hope," as Mr. Farmer expressed it—and if we had not had some basis for the idea that it could be done. How it is going to be done, I cannot say; I simply don't know.

Mr. Farmer: If the Court please, the parties to the litigation who join issue on the averments that there can be a plan, and when the petitioner comes in court and asks the Court to take jurisdiction, are entitled to show those vital, material facts which will militate against any feas-

ible plan being proposed and confirmed, and on this side of the table we conceive, and especially I representing some [fol. 475] contract holders, conceive that this deficit of $2,600,000 admitted in the petition is about the most vital and material fact that militates against the prospect of any plan.

The Court: All right, but they are not attempting to prove by this witness there is such deficit. That is admitted. That becomes a matter of argument later. Why ask this witness?

Mr. Farmer:

Q. Mr. Marshall, you said you had talked with some other people, and I believe you said with some authorities, did you not, about the prospect of a reorganization?

Mr. Fleming: The debtor objects.

The Court: Overruled. (Exception.)

A. I have talked to people who have had experience in reorganization. I think probably you misunderstood me. I said that I had talked to people who had told me they had talked to authorities.

Mr. Farmer: I object to that, your Honor, when he says that he has talked to people who told him they had talked to authorities.

The Witness: I mean our own people.

Mr. Farmer:

Q. You have not talked with any of the insurance commissioners or securities commissioners in these different [fol. 476] states where the company has been doing business and where it must go back and do business if it is reorganized, about whether there can be any plan of reorganization put into effect, have you?

Mr. Fleming: The debtor objects.

The Court: Overruled. (Exception.)

A. I have explained that, Mr. Farmer—that I have not. I have assumed though they would have just the same interest I have in it. That would be the interest of the contract holders, and that they would prefer reorganization rather than liquidation.

Mr. Farmer:

Q. You would assume also, would you not, that they would try in every way to uphold their duty to the contract holders in those states where the company has sold these contracts on the faith and strength of the deposits and securities being held in those states to guarantee the performance by the company of its obligations in those states, and you would assume that a reorganization of the company that initiated those contracts and obligations in those states could not hope to launch off on a successful career selling people on a savings plan again?

Mr. Fleming: The debtor objects to that question.

The Court: Sustained. (Exception.)

[fol. 477] Mr. Farmer:

Q. Now, Mr. Marshall, you said this company, since December 31, has not engaged in any business except just to receive such moneys as came in?

A. That is my understanding.

Q. Now, during this last seven or eight months you have turned the possibility of reorganization over in your mind every day, have you not?

Mr. Fleming: The debtor objects.

The Court: It seems to me you are going along the same line that Mr. Palmer pursued. I am not going to permit that. If you have anything separate and apart from what Mr. Palmer brought out, I will be glad to permit it.

Mr. Farmer:

Q. Well, you have said you concluded it would take an umbrella of some court proceedings over it——

A. I did not say I did.

Q. Well, that somebody else said it would take an umbrella——

Mr. Fleming: The debtor objects.

Mr. Farmer:

Q. All right, let me ask you what you meant by "umbrella"?

The Court: Overruled.

(Exception.)

A. Well, that a plan of reorganization would have to be effective with all the commissioners, that to under- [fol. 478] take to reach an accord with all the commissioners, to go from one state to another and undertake that was an impractical thing, and that the only effective way would be to do as we are doing in this proceeding, so that a plan can be worked out and there is just one tribunal we have to deal with, although all the other parties have rights and their rights are protected in this court.

Mr. Farmer:

Q. Isn't this the situation in a nutshell, Mr. Marshall, that this company is faced with the situation where it has been doing business in a great number of states and in those states it has deposited some of its assets to attempt to comply with the laws of those states?

A. Yes, sir.

Q. And under those laws those assets must be held for the protection of the policy holders in those states; isn't that right? And those officials——

Mr. Fleming: The debtor objects to that question as calling for a legal conclusion.

The Court: Let us see if it does.

Mr. Fleming: That is the question your Honor will be called upon to decide in the future.

The Court: He has not finished the question yet. You may proceed, Mr. Farmer.

[fol. 479] Q. And those officials in those states who hold those deposits are attempting and intend and will endeavor to perform their duty to the citizens of those states by holding those deposits, and unless some power can be found to take those assets back and take them away from those states and cut down the rights of the citizens of those states to those deposited securities, then the company has no chance of reorganization?

The Court: The question is improper and the objection is sustained.

(Exception.)

Mr. Farmer: On what ground, if the Court please?

The Court: Just because it is sustained. The Court does not have to announce the ground.

Mr. Farmer: That is all I care to ask.

Mr. Palmer:

Q. Mr. Marshall, at your Pittsburgh meeting is it not true that the concensus of the meeting was that under the state proceedings each state was proceeding separately and that the board of directors, or the gentlemen there purporting to be the board of directors, believed that by bringing a suit in a United States District Court all of the assets of the various states could be collected and administered in one suit?

A. I don't remember that being stated precisely that [fol. 480] way. My recollection is just what I think I testified to before; that we felt that a reorganization could not be effected if we had to go around all these separate tribunals, and I might say that your senior partner concurred in that belief, and in conversation with Mr. Fleming and me he so expressed himself, but said he did not think this was the time, that all the ground work ought to be done in the state receivership first, but finally that method would have to be undertaken.

Q. And was not the reason of the filing of the suit here by this board of directors so that all of the assets in all of the various states could be collected in the hands of one trustee?

A. I never heard that suggested. It did not register with me, if it was stated. I think the resolution accurately depicts what was decided upon.

Mr. Reinhardt: Your Honor, I have just a few questions.

The Court: You may proceed.

By Mr. Reinhardt:

Q. There has been a lot of talk here about umbrellas in this testimony. I wondered whether the modification of the charter which took place in the latter part of 1940 could be regarded as a kind of umbrella, Mr. Marshall?

[fol. 481] A. The expression was not originated by me. It came afterwards and it was reported to me to have originated in your building.

Q. I think you are crediting us with something we are not entitled to, but it is a hallowed expression and, I think, a very apt one.

A. It is possible someone else might have said that, but that is really where it was reported to me that expression came from, that it would take the umbrella of the court.

Q. Is it fair to say that the modification of the charter was a sort of an expedient adopted by the company in view of the fact that the investment company act was about to become effective and the company knew it could not readily comply with the requirements of that act?

A. I should say, Mr. Reinhardt, all during this period we were tryng to evolve something that would be satisfactory to the Securities and Exchange Commission and to Mr. Sims, and on several occasions we thought we had parties interested who came and talked to officials as to whether or not the plan would be feasible, and this was just another one, as I looked at it.

[fol. 482] Edgar B. Sims, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. What is your name, please?

A. Edgar B. Sims.

Q. Where do you live, Mr. Sims?

A. Charleston, West Virginia.

Q. What is your official position?

A. Auditor of the State of West Virginia and Ex Officio Insurance Commissioner.

Q. How long have you held that position?

A. Since March 4, 1933.

Q. Mr. Sims, as part of your duties, did there come a time when you supervised securities which were deposited with the proper authorities of the State of West Virginia by the Fidelity Investment Association or the Fidelity Assurance Association?

A. That is part of my duties under the law of this state, yes.

Q. How long have you had that relationship or have you been performing that service or duty for the assets deposited by Fidelity?

[fol. 483] A. I have been attending to it for over eight years.

. . . . . .

[fol. 484] Q. Now, in determining the amount of securities to be deposited by Fidelity, what type of value did you use?

A. Well, early in 1934, I believe, I promulgated a method of evaluating securities somewhat similar to that used by the Comptroller of the Currency for national banks, and somewhat, but not so closely, related to the Insurance Commissioner's method of evaluating securities.

Q. I was wondering if you would tell the Court what amount in value of the securities of Fidelity were deposited with the Treasurer of the State of West Virginia here in Charleston on the 6th day of June, 1941.

Mr. Lauritzen: Will you ask him what kind of value, whether market value, or what?

Mr. Fleming: Yes.

The Court: I did not get clear that the witness had answered the other question, Mr. Fleming. You asked him which one of these, the par, the sound or the market value was used, and I don't believe he answered that, did he?

Mr. Fleming: I will withdraw the question.

Q. Now, Mr. Sims, will you answer that question the Court had reference to?

A. I have applied the sound-value method in this state.

[fol. 485] The Court: Well, find out what that is.

Mr. Fleming:

Q. Now, how do you arrive at that, Mr. Sims?

A. In 1934 I prepared that method, which I cannot quote exactly. There are copies of it in my office and in the regular proceedings in former litigation in Wheeling, concerning the company; but, broadly speaking, all those bonds that were paying their interest, not in default in principal, were rated at par, regardless of what the company had paid for them. For instance if they paid 110, that would put them at 100; if they paid 80, we put them at 100.

The Court:

Q. What bearing did you give to the current market price?

A. Your Honor, on bonds which were in default in principal or in interest, they would be put down at absolute

market, which is a harsher method than that used by national bank or state bank examiners in that regard.

Q. Suppose a bond was not in default, but was selling at 50 on the market. Would you still count it at 100?

A. For the purpose of determining whether it was a going concern, I had to do that. We started that in 1934, when there was no basis of valuation.

[fols. 486-489] Mr. Fleming:

Q. Did you do that in figuring the assets of Fidelity deposited with the State?

A. I did. I will say further, the company paid thirty-two for $300,000 worth of certain bonds. I allowed them to go in at par. They are worth 90 now, and never have defaulted. The market price is what somebody thinks they are worth, but the interest paid tells the story.

The Court:

Q. That is upon the theory of giving credit to a going business, meeting its obligations?

A. Yes, sir. If the Court will permit me: it is strange that my method of valuation worked out rather well with the Insurance Commissioner's method and the method employed by the national bank examiners. On one occasion we thought we would test them out, and on a large concern like this it panned out rather closely, not over 3% variation of total worth.

[fol. 490] Q. As I understand, Mr. Sims, your primary obligation is to look after the securities and evaluate the securities that are deposited under the laws of the State of West Virginia; is not that right?

A. That is correct.

[fol. 491] Q. In carrying out the law, you certainly must have these figures somewhere, have you not?

A. Oh, they are taken, an over-all picture, twice a year; but I don't care so much for one state. What I am after is the over-all picture. That is what I pay attention to particularly, ever since I have been there.

Q. You are primarily interested in West Virginia, and not primarily interested in Wisconsin or Tennessee; isn't that right?

A. The law makes it my duty to look after all of them.

Q. Because you supervise directly the activities of Fidel-

ity by reason of its being incorporated under the laws of the State of West Virginia; is that right?

A. Yes, sir; but there is a big excess in the State treasury under the liabilities existing in the State of West Virginia. I do not know how much, but I know it is large.

Q. But the Treasurer of the State of West Virginia has in his custody a large amount of securities that are allocated for the benefit of contract holders living in other states; isn't that right?

A. Yes, sir.

Q. What I would like to know, Mr. Sims, is what amount [fols. 492-497] of securities, appraised either at their sound value or market value, were on deposit with the State of West Virginia, on or about June 6, 1941.

A. There was approximately $13,000,000; I am not sure whether that is market value or sound value.

Q. Approximately $13,000,000?

A. Yes, sir.

* * * * * * *

[fol. 498] Mr. Lauritzen: I would be glad to, your Honor.

Exhibit No. 24 is an exhibit by Mr. Sims, the Auditor of this state, and, briefly, it certifies that on December 31, 1940, the company amended its charter, and a copy of the amendment is inserted. It shows that Mr. Sims, as Insurance Commissioner, approved that amendment; that subsequently that amendment was approved by the Secretary of State, as amending the corporate charter of the company, and it shows that on the same date, December 31, 1940, the corporation made application, a copy of which is [fol. 499] attached, to the Insurance Commissioner of the State of West Virginia for license to engage in the life insurance business as provided in Article 3 of Chapter 33 of the 1931 code of West Virginia as amended, and such license was granted, a copy of which license is also attached.

Then, it shows further that on January 13, 1941, the company made application on forms supplied by the Insurance Commissioner for that purpose for the licensing of twenty-one persons to engage in the sale of life insurance policies, which said licenses were issued.

It shows further that on January 14, 1941, the company filed in duplicate and secured approval for use in this state of a form, entitled "Special Annuity Contract".

It also shows that on January 27, 1941, the company filed, in duplicate, and secured approval for the use in this state, of the following forms: Ordinary Life, Ten Payment Life, Fifteen Payment Life, Twenty Payment Life, Fifteen Year Endowment, Twenty Year Endowment, and Ten, Fifteen and Twenty Year term.

It further shows that the licenses issued to the company as an insurance company, as of December 31, 1940, expired on March 31, 1941, and that a renewal of that license was issued dated April 1, 1941, for a term of one year, expiring [fol. 500] March 31, 1942.

The Witness: Your Honor, may I explain?

The Court: Yes.

The Witness: Those licenses were actually issued, but the company was told not to sell anything until they got right with our office. I did that for the purpose of—licensed them for the purpose of receiving installment payments on the outstanding contracts.

Mr. Jaegerman:

Q. The face amount certificates they had issued up previous to that date?

A. Yes.

The Court:

Q. You say you told them not to use it until they "got right" with your office. Did they ever get in shape so they were permitted to use it?

A. No, sir.

(Recess from 3:40 p. m. until 4 p. m.)

The Court: All right, Mr. Palmer, are you ready to proceed with your cross-examination?

Mr. Palmer: Yes, your Honor.

Q. Mr. Sims, you were first elected auditor of the State of West Virginia when, or you first took office when?

A. March 4, 1933.

Q. And you have been continuously since that time?

[fol. 501] A. Yes, sir.

Q. Auditor of the State of West Virginia.

A. Yes.

Q. And under the laws of the State of West Virginia as Auditor, you are also Ex Officio Insurance Commissioner?

A. Yes, sir.

Q. And under your supervision is the securities department of West Virginia?

A. Yes, sir.

Q. Did you have any knowledge, other than general, of Fidelity Investment Association, prior to your taking office?

A. No, sir.

Q. And your connection with them and your knowledge of them has been through your official capacity since you took office; is that correct?

A. That is all.

Q. Now, you are governed by the statutes of the State of West Virginia, and were governed during your relations with Fidelity Investment Association; is that correct?

A. Yes, sir, as far as the circumstances would permit.

Q. You were and are required, under those statutes, to [fol. 502] exercise a discretion which is invested in you; is that correct?

A. In evaluating securities that is the case.

Q. And in your supervision of Fidelity, and other companies of this type, you have certain discretionary powers which you exercise?

A. Yes; but sometimes it does not avail anything.

Q. What?

A. Sometimes it did not avail anything.

Q. The statutes of West Virginia require that certain deposits be made with the State Treasurer, by reason of companies such as Fidelity Investment Association doing business; is that correct?

A. Yes, sir.

Q. And did you require those deposits to be made?

A. As much as I could obtain.

Q. As much as you could obtain?

A. Yes.

Q. Now, in connection with that, did you have from time to time conferences with the officers and directors of Fidelity Investment Association?

A. Yes, sir.

Q. Did you, not at length but briefly, go into that from [fol. 503] the time you took office, as to what, through your official capacity, you advised them to do and wanted them to do in connection with making deposits, and in running

their business in accordance with the laws of the State of West Virginia, as you saw it?

A. Well, I was wholly unacquainted with this business when I came into office. You know, I had been a school teacher and a peddler and there were some things I had to learn. However, I soon found out that their liabilities far exceeded the market values of their holdings, and I discovered a lot of advances by Fidelity to the National Sales Agency, Inc., of $957,000. I questioned the propriety of that and the validity of the note. Various and sundry persons connected with the company assured me it was perfectly good, that it was a perfectly good note; that it was out on anticipated commissions that were earned and would come into the treasury of the company.

Q. How much was the amount of that note?

The Court: He said $957,000.

Mr. Palmer:

Q. Proceed, Mr. Sims, if you will.

A. And I kept watching them and checking from time to time on the values of securities. At that time I had Mr. Bradford, who later went with the Securities and Exchange [fol. 504] Commission, in the office. I could not get them to reduce that note, as I had ordered them to do. I ordered them to reduce the note out of earnings of the sales agency, and to limit their expenses in the operation of the company to the loading in the contracts sold.

In other words, I demanded that they operate the company upon the loadings for commissions to the salesmen and bookkeeping, and at the same time show a profit to reduce this huge note.

They told me they were obeying me.

Q. Did they obey you?

A. No, sir.

Q. And instead, when you further investigated, what did you find out?

A. I found at the end of the year that they had increased that note by $90,000.

Q. And what action did you take then, Mr. Sims?

A. Immediately I called the directors together. They met in Washington and I appeared before them.

Q. Tell us what occurred there, please.

A. Well, I took my coat off.

Q. And what went on then?

A. I told them at the time to get somebody in charge of [fol. 505] the company who knew what stealing was when they saw it, and was opposed to it. The president of the company said he had been obeying me, and right there we disagreed. I told them he had not; that he had disobeyed me, and his board of directors, because they had been ordered to take $10,000 a month out of Fred King's commissions, and apply it on he note, and to pay the interest.

Q. Who was that man?

A. Senator Sutherland.

Q. About approximately when did this conference occur?

A. Some time in 1934.

Q. Go ahead and tell us what you did further, if anything.

A. Well, I ordered them to decapitate Fred King.

Q. Was that done?

A. They did not do it. Well, I got in my car and rode to Wheeling, and walked in the president's office, and wrote in pencil on a slip of paper to go over and take charge of the sales agency's bank account, and put it in the company's till, or I would close them down at the end of business that day.

Q. Did they do that?

A. They did.

[fol. 506] Q. What other suggestions did you make, or orders did you give?

A. In the meeting in Washington, I laid down this formula which has been introduced in evidence here, in substance; I delivered that in my speech to them there, with the additional advice that they buy bonds every month with their collections. They were taking in from three hundred thousand dollars to half a million dollars per month, and I insisted they buy bonds that never defaulted in the depression in interest or principal, and they could be bought at a huge discount at that time, and to keep on buying and buying and buying as long as they had any money to buy them with, and had any bonds in sight to be bought at a discount.

Q. Did they follow that advice?

A. Mr. Young in New York has done that nobly, I must say.

Q. Has the wisdom of that suggestion or order been indicated to you at times?

A. Yes, sir; the company was in the red in market values in 1933 about $7,000,000, and in market value today it is in the red only two and a quarter million dollars.

Q. Has that decrease of being in the red been by virtue of the following out of the policy you laid down for them [fol. 507] in buying bonds at discount and holding them?

A. It has, in spite of the reckless squandering and spending money by the officers in Wheeling.

Q. Now, with reference to that, you say you ordered them to cut down their expenses and salaries and so forth. Did they do that?

A. They told me they did. They said they were living within their means and operating at a profit; but I found out last February, when I examined the books down here in the bank building on the river bank, the office building, it is now, that they had advanced $480,000 to the sales force.

Q. Were they using a prohibitive amount of money to sell their contracts?

A. They were spending money in excess of the commissions loaded in the contracts and collected.

Q. And was that amount a larger amount, in your opinion, than should have been spent for selling these contracts?

A. It certainly was. It was taking money that belonged to the stockholders and contract holders and giving it out to a lot of "gimme" gang salesmen.

Q. Now, from time to time during that period, did you [fol. 508] order them to cut down their expenses?

A. I did.

Q. Did they obey you?

A. They would obey it for a time at the home office, and then the first thing I would know they would skyrocket the salaries again. I ordered them to cease renting expensive offices for the sales managers all over the country, and they assured me they would do it as fast as their contracts or leases expired, and they could do it.

Q. Did they do it?

A. No, they were still paying $9,000 a year in Chicago for expensive offices, and I closed them; and they were making advances to their hirelings—I think, for instance, Mr. Pulfer had an $8,000 advance at the date of closure; A. L. King of Wheeling, a $3300 advance, with no security.

Q. What can you say as to whether or not the company told you they were making profits and paid dividends to

stockholders when, as a matter of fact, they were not making profits?

A. Of course, I am not an expert accountant; but, in my opinion, they have not earned a dollar in ten years. If they paid an income tax, they paid it erroneously, in my [fol. 509] opinion.

Q. Did they, during the last ten years, pay these dividends out to the stockholders?

A. I think they did for two or three years, over my protest and advice. There is one year I cannot say much about, in the year 1937, when the prices of bonds were sky high, and they were in the black by about $800,000 in market values.

Q. Mr. Sims, do I understand you correctly that by virtue of their type of investments that the economic period, or the economic phase, of the United States may at one time, on market value, have made their securities inadequate to meet thier liabilities, and a short time or months or years later, due to economic changes, the same securities may be more than adequate to meet their liabilities?

A. Yes, they were able to meet their liabilities in 1937, according to the statisticians.

Q. And that is on market value?

A. Yes; but that was occasioned by the great intake of money and the purchase of bonds and the rapid rise in market value of bonds.

The Court: Does that simply mean, in any company like this if they start up on a rising market, they can remain [fol. 510] solvent, but if they start up on a high market, after that closes down, they will become insolvent? Is that what it means?

A. Yes, sir, your Honor. That is the reason the insurance commissioners and bank examiners all over the country do not take the market value at any particular period, but rather take the average and devise some method of charging the securities so as not to give unduly high values to them as such at any particular time, or unduly low values at any other time.

Mr. Palmer:

Q. So that is why you evolved your plan of what you call sound value?

A. Yes, sir.

Q. It was not a plan which would be based on the liquidation of a company at any one given date, but rather the sound value of the company over a given period of time?

A. Yes, sir. Of course, that is, you understand, assuming that they will not eat up their future in riotous living in any particular year or period of years.

Q. What can you say as to this company being able to compete with the sale of government defense bonds and other bonds by the United States Government, which yield the investor practically 2.9%, as compared with this com-
[fol. 511] pany, which averaged a yield to the investor of only 2.56%; that is, whether it can compete with the government bonds backed by the United States Government?

A. Of course, that is problematical. It may be that government bonds will pay a higher rate of interest in the future; or it may be they will pay a lower rate, but a company like this cannot pay 4 or 4½% on its contracts, now, because it cannot invest its money in first-line bonds and earn that.

Q. And the only way it has been able to exist over the last few years, to your own knowledge——

A. Is because they bought bonds on a low market.

Q. Yes, is because they bought bonds on a low market, on your advice, and those bonds have now risen, due to higher market.

A. Yes, sir.

Q. And that is the only reason they have been able to exist during this period of time; is that correct?

A. That is the only reason they are improved in their financial statements.

Q. And is it not a fact that contracts of this type can only be sold to the general public by means of what is called "high pressure salesmanship"?

[fol. 512] A. Yes.

Q. That is salesmanship which is expensive to the company who tries to put it on?

A. That is the way they have been sold, at too great an expense.

Q. And were they able to sell them any other way, Mr. Sims?

A. I don't know; they never tried it.

Q. Mr. Sims, as Ex Officio Insurance Commissioner, whenever you felt a company of this kind had its obliga-

tions impaired, you are permitted to file a suit in the Circuit Court of Kanawha County to collect the assets and administer them; is that correct in substance?

A. Yes, sir.

Q. And did you at any time determine that such a suit should be brought by you to collect the assets and administer them?

A. Yes, sir.

Q. And that was the suit of April 11th; is that right?

A. Yes, sir.

Q. Mr. Sims, in that suit you did not, however, turn over to the state court receivers the deposits made to the State of West Virginia?

[fols. 513-517] A. No, sir.

Q. You did keep those under your own control?

A. Well, that is debatable as to who has control of them.

Q. In any case, they were not turned over to Mr. Ross B. Thomas and H. Isaiah Smith, the state court receivers?

A. No.

Q. To your knowledge, Mr. Sims, was this note of the National Sales Agency ever paid off?

A. The records show that by gradual payments the note was reduced to around seven hundred or seven hundred and fifty thousand dollars.

Q. And is there any security at all to back that up to make it worthwhile?

A. Nothing except the paper it is written on. We struck it out in casting up the assets of the company.

* * * * * * *

[fol. 518] Mr. Palmer:

Q. Pardon me, but did you investigate the connection of Mr. Messick with the debtor company?

A. I had been informed that Mr. Messick and another man had agreed to put up half a million dollars to form a side corporation and take over this company by degrees, and it went on for a long time and I began to make inquiries through Mr. Young in New York—I visit his office every time I go there to sign road bonds—and through Mr. Arthur Koontz I learned that Mr. Messick was chairman of the board at $1,000 a month. I learned immediately that the president, Mr. Risley, the attorney and perhaps another individual from Wheeling were coming to my office, and I

prepared a letter and ordered them to decapitate Mr. Messick as chairman of the board at $1,000 a month.

The Court: Who was that attorney?

A. Mr. Tom Foulk.

Mr. Palmer:

Q. You, in your official capacity, knew that there was a plan being formulated whereby Mr. Messick and an asso-
[fol. 519] ciate would invest half a million dollars of new capital and take over this company, and put this amount of money in as new capital?

A. I am not sure it was a real plan. There may have been a pretended plan, a device to get inside; I don't know.

Q. Can you recall approximately when this idea of Mr. Messick's was attempted to be worked out, about putting forth the half million dollars, that is?

A. A year and a half ago, something like that; maybe two years.

Q. After you ordered them to cut off Mr. Messick's salary of $1,000 a month, was that done?

A. That is what the officers of the company tell me.

Q. Did Mr. Messick have at any time other than a one share nominal interest in the company?

A. Not to my knowledge.

Q. Is that the same Mr. Allan G. Messick who was on the 7th day of June, 1941, employed by the Trustee, together with Mr. James Fleming, who was employed by the Trustee "for the purpose of assisting your Trustee in marshalling the assets of said debtor, which are now institute in divers states outside the territorial limitations of the State of West Virginia, and also for the purpose of assist-
[fol. 520] your Trustee in the development and formulation of a plan of reorganization for the affairs of debtor in this proceeding".

The Court: You are mistaken in your premise to the question. Mr. Messick was never employed by the Trustee.

Mr. Fleming: And neither was I.

Mr. Palmer: Your Honor, I think a petition was filed in this Court, asking for authority to employ them for that purpose.

The Court: Yes, but that was not your question. You asked him if he was one of the persons employed by the Trustee, and he has never been employed.

Mr. Palmer: I beg your pardon, perhaps I did not read it correctly.

Mr. Fleming: I might say further that, at my personal request, the Court vacated that order.

The Court: The Trustee filed a petition requesting authority to employ Mr. Messick and Mr. Fleming, but they were never employed and the Trustee later filed a subsequent petition asking that that order be vacated, which it has been, as to both Mr. Messick and Mr. Fleming, and they never had any connection with the Trustee.

Mr. Palmer: What I wanted to do, your Honor, is to get from this witness the connection the Mr. Messick of whom [fol. 521] he is speaking and the Mr. Messick about whom the Trustee was speaking—if they are one and the same person, that is.

The Court: All right.

A. It is the same man. The same man is here.

Mr. Fleming: Is this supposed to be a personal attack on me? If so, I want to know it.

Mr. Palmer: No, sir; I am merely citing to the Court certain parts of this record, and I am also citing the facts that occurred at the meeting in Pittsburgh. It is in the answer filed by Mr. Sims.

Mr. Fleming: And prepared by you.

Mr. Palmer: Prepared by the Attorney General.

Mr. Fleming: If Mr. Messick has done anything illegal, I think that fact should be disclosed; if he has done anything of that nature as chairman of the board of directors of the company.

The Court: That is what I am looking for.

Mr. Fleming: And if I have done anything dishonorable as attorney for the debtor, let that fact be disclosed. I don't think it is either fair or honorable to make veiled attacks on counsel or any one else in this case, if the Court please.

Mr. Palmer: Mr. Fleming, I think you are entirely cor-[fol. 522] rect and I am only citing from the answer of the Auditor in which it charges that under Section 157 you do not have a right to appear in this proceeding.

Mr. Fleming: I have a right to appear in this proceeding as attorney for the debtor.

Mr. Farmer: Your Honor, it seems to me that this is competent on this ground, that we are entitled to show the

entire relationship that those parties who brought this proceeding here in this Court have had with this company. Mr. Messick's relations extend back over this period of years, trying to do something with it, and also we think we are entitled to show their relationships with the Trustee.

The Court: In so far as the question relates to matters of good faith in filing the petition, I am going to let you question Mr. Sims about Mr. Messick, but as to the last question in regard to certain things you say appear in the record, I am not going to permit that because neither Mr. Messick nor Mr. Fleming have ever had any connection with the Trustee.

Mr. Palmer: Your Honor, we want to show this: that Mr. Messick and Mr. Fleming were two of those who were present at the meeting in Pittsburgh, at which time the resolution authorizing this petition to be filed was presented; that [fol. 523] the records disclose that that petition was filed June 6th, and that the following day the Trustee filed a petition asking to employ these two persons for the purposes set out in that petition; that an order was entered and that then the Court had a preliminary hearing and that matter was dismissed when objection was specifically raised by Mr. Wood on behalf of the contract holders to the employment of Mr. Messick in any——

Mr. T. C. Townsend: That was not the reason for it at all.

Mr. Palmer: We want to show the entire line of conduct from the meeting in Pittsburgh until the Court, himself, and the Trustee asked that he not have any further connection with it.

Mr. Fleming: That fact is not disputed, that we had the meeting, of course, and all the evidence goes to show that, and we had a right to be there, just the same as Mr. Sims has a right to come here, and it seems to me that an effort is being made to impute motives to people that probably have motives just as honorable as Mr. Palmer or Mr. Sims or any one else.

The Court: At any rate, there is no expectation that you can get from this witness that any of those things you [fol. 524] have just stated are not true, and nobody is denying them, so why ask him about it?

Mr. Palmer: My question, your Honor, which started this discussion, was to ask Mr. Sims if the Mr. Fleming he knew and meant was the same one who carried on these later

proceedings, and that is admitted now, so I will not go further into that.

The Court: All right.

Mr. Palmer:

Q. It is set out in your answer and shown by a table, that there would be approximately 117 classes of creditors, being derived from the fact that there are fifteen states where deposits are required and twenty states in which the debtor was required to obtain a license, and then there were seven or more of the various series of contracts. Mr. Sims, do you have any knowledge personally as to whether a plan of reorganization can be worked out that will be approved by 66⅔% of the 117 classes of contract holders?

A. I do not.

Q. In the event of liquidation of this company, is your department of the State of West Virginia prepared and permitted by law, and adequately equipped to do whatever steps are necessary to administer and liquidate the affairs [fol. 525] of the company in West Virginia?

The Court: In West Virginia, or in all other states?

Mr. Palmer: In West Virginia only, your Honor, of course.

The Court: All right, then. He may answer that question.

A. No, sir; we do not have the room nor the employees, and I would not do it if I had the room or the employees at the State's expense.

Mr. Palmer:

Q. Now, Mr. Sims, there has been considerable testimony here concerning whether or not a reorganization can be had of this company into any sort of company whereby it would sell face amount certificates and whether it could or not. Have you formed any opinion from your experience with this company, and other companies, as to whether or not in the present economic times a face amount certificate company could be reorganized which could comply with the Investment Company Act of 1940, and which could successfully operate?

A. You mean reorganize with the corpse of this one?

Q. Yes.

A. No, sir.

Q. You base that on your experience that you have had [fol. 526] as State Auditor and your knowledge of this company and its affairs?

The Court:

Q. Mr. Sims, you asked the question whether he meant to reorganize out of the corpse of this one. What do you mean by that?

A. With the same outfit, the same aroma and halo around the things which has been there: no company on earth can be successfully managed by such a crowd as they had up there, or any of their hirelings.

The Court: That is what I thought the witness meant and, for that reason, I suggest to Mr. Palmer that the answer is not of any particular benefit to the Court.

Mr. Palmer: Your Honor is undoubtedly right.

Q. Mr. Sims, would it be possible for any one to successfully operate a face amount certificate company which could in these economic times operate successfully?

A. I doubt it very sincerely.

Q. Let me ask you one other thing: has the fact that this particular company has first been in state receivership and now in bankruptcy proceedings in this Court had anything to do with the fact that it would be difficult to reorganize this particular company as a new company?

A. That would be a factor to consider; a very grave one. [fol. 527] Q. And would it be a favorable or adverse factor, do you think?

A. A very grave one.

The Court: You say in your opinion you have very sincere doubts whether any face amount certificate company could operate successfully. I want to ask you with reference to this particular company, which has already gotten into an insolvent position, whether in your opinion a reorganization on some basis, forgetting about the "crowd", as you called them, that have been in control before, other than immediate liquidation, will have a fair chance of producing more for the contract holders than immediate liquidation would.

A. I had thought so. I had thought it could be reorganized into an insurance company by the consent of the contract holders:

Mr. Palmer:

Q. Mr. Sims, that was your idea in the state court proceedings, was it not?

A. Yes, sir; that was one of them, and the other was to get rid of that gang that had been wrecking it.

Q. Mr. Sims, under the statutes whereby you are required, in the case of insolvent insurance companies, to [fol. 528] administer their assets and, if necessary, to bring suits in Kanawha County for the purpose of aiding you, you had done that in this case, and were prepared to go through with it, were you not?

A. I was going to attempt it. I don't know whether I could have gone through with it or not.

Q. You have brought such suit, seeking the aid of the Circuit Court of Kanawha County; is that correct?

A. Yes, sir.

Q. You were prepared to attempt to carry out the law to the best of your ability; was that right?

A. I always try to.

Q. And if it had been necessary to employ further employees and get additional space to carry that out, you would have complied with the law and have done so; is that right?

A. I would have done it at the expense of the company.

Q. And so far as you are concerned, you would have complied with the requirement of the statutes to administer and liquidate if need be?

A. Yes, sir.

. . . . . .

[fol. 529] By Mr. Townsend:

Q. About the first thing you did, as I understand it, after you were elected Auditor, with reference to this company, was to investigate the National Sales Agency; is that right?

A. That was one of the things.

Q. That was one of the first things you did; isn't it?

A. We did it some time; I don't know how soon it was, Mr. Townsend.

Q. Well, it was not very long after you assumed office; isn't that right?

A. Possibly within a few months; yes.

Q. And, of course, in your first investigation you discovered enough irregularities, as you thought, to condemn the sales agency?

[fol. 530] A. Worse than that.

Q. What do you mean by "worse than that"?

A. I could use a shorter and uglier word than that, Mr. Townsend.

Q. I don't yet know what you mean.

A. Well, it might be improper for me to use that word in the presence of the Court.

Q. At least, you thought it should be ended?

A. Yes, sir.

Q. And you felt rather vigorously about it; didn't you?

A. I did.

Q. And that was soon after you went into office?

A. Yes; but they fooled me by assuring me that the money would be repaid immediately.

Q. How long did it take you to get rid of that?

A. It took me about a year; and then I had to take a club with nails in it and hit them over the head.

Q. Well, I think you did a good thing when you did get rid of them.

A. I just delayed too long.

Q. Then you looked into the salaries and expenses of the company?

A. Yes, sir.

[fol. 531] Q. What did you find?

A. It seemed they were spending a lot of money.

Q. Well, in what respect were they spending a lot of money?

A. Oh, they had a far-flung sales program, reaching all over the country.

Q. We have eliminated the sales organization, now. What other expenses outside of that did they have that were excessive?

A. Oh, a lot of high-priced officials.

Q. Who were they?

A. Well, Mr. Sutherland was president.

Q. What did they pay him?

A. About $15,000 a year.

Q. Any other high-salaried officers?

A. A. L. King, Fred King, Evans and Reed.

Q. Were they all connected with the company or with the sales agency?

A. Well, they put them on the company payroll, most of them.

Q. After you eliminated the sales agency, the company employed them, you mean?

A. As I recall, most of them went on the company pay-[fols. 532-533] roll, yes.

Q. Was Fred King ever on the company payroll?

A. No, I told them to get rid of him. I would not stand for that.

Q. You have not yet told me of but one salary that was paid, and that was $15,000 a year. Did they have any attorneys' fees in there?

A. Yes, sir; but I cannot tell you without the record, from memory, about that, because that was eight years ago.

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[fol. 534] Q. The company probably would be sound to-[fol. 535] day; isn't that right?

A. Except for one thing, Mr. Townsend.

Q. What is that?

A. They promised too much in their contracts, and the economic change in interest rates, money rates, wouldn't stand that.

Q. Well, if it had been sound in every other respect except that, would it not have been possible, Mr. Sims, to have so modified the contracts, or at least the future contracts, so as to place this company in a sound condition to continue under your spendid management?

A. That is what would have to be done. You would have to modify the contracts.

Q. Well, it could have been done; I mean, the contracts could have been modified, the future contracts, and brought in line with existing economic conditions?

A. You would have to modify all contracts.

Q. No, I am talking about not all of them, but the future contracts.

A. No, it is doomed to distress with the present promises in their old contracts sold back in 1920 to 1932, that they would receive $1200 in installments, over a period of ten

years, and taking out the loading for commissions and book-
[fol. 536] keeping, leaving around $1100 in cash, and at the end of ten years they would begin paying back $200 a year for ten years,—well, it is something that cannot be done; simply a mathematical proposition that won't work.

Q. Mr. Sims, let me see if I understand you. The structure of the company economically and financially was unsound from the beginning; is that right?

A. Yes; they promised too much in the twenties.

Q. And never could have succeeded?

A. Not at that rate they were promising.

Q. No matter about the extravagance or anything else; if run economically it was bound to be condemned; is that right?

A. I think so. I think they were quarreling with Ray's arithmatic all the time back there; and there was another reason it was doomed to failure. They had bought German government bonds, Mexican bonds and second mortgage bonds and fourth mortgage bonds, and of course, they are not worth much.

Q. That gets back to the management?

A. Yes.

Q. That doesn't have anything to do with the structure, [fol. 537] the financial structure of the company. Now, I have a statement here showing about $53,000 paid out in 1939 for legal expenses. Do you know anything about that?

A. They paid too much out to auditors and for legal expenses.

Q. I did not ask you about auditing; I asked you about legal expenses.

A. Yes, sir; that expense was too much. They spent an enormous sum for legal expenses.

Q. Did you make any complaint about that?

A. I did.

Q. Did you have them dismiss the attorneys because of your complaint?

A. That was the thing I could not control, the lawyers' fees.

Q. They paid them out of money under your control; did they not?

A. I wish I could have had control of it.

Q. Well, you fired King, and you fired Messick; why didn't you fire the lawyers?

A. If I had had authority to, I expect I would have.

Q. The only reason you did not do it was because you did not have the authority?

[fol. 538] A. If I had had the authority, they would have been fired and the salaries divided in about four.

Q. I say, the only reason you did not fire them was because you did not have the authority?

A. Yes, sir.

Q. Did not you have the same authority over the expenses of the company, so far as paying lawyers was concerned, as you had with reference to paying any other officials?

A. I am wondering if I did not exceed my authority then.

Q. You mean in firing the officers?

A. Yes.

Q. Well, it would not hurt you and would make no difference if you exceeded it once more, would it?

A. I did it and got away with it, and I am glad I did it. If I had it to do over again, I would do it sooner.

Q. In 1938, '39, '40 and '41, the books of the company show $92,000 paid to one firm of lawyers. Did you scan those accounts?

A. I never saw them; don't know what firm it is.

Q. You stated, in reply to a question asked you by Mr. Palmer, that no new annuity company or insurance company [fol. 539] or face amount installment certificate company could operate in West Virginia without a license from you, did you not?

A. I think that is the law.

Q. I am not disputing it.

A. Of course I am not a lawyer.

Q. Well, you said that?

A. Yes.

Q. And you said also that you would not license any company that might be built upon the corpse of this company to write installment contracts in West Virginia; did you not?

A. That is what I said.

Q. Suppose the company was reorganized out of new cloth entirely. Do you feel that you would——

A. (Interposing.) I just doubt——

Q. Just a minute, now. Supposing it was reorganized out of new cloth entirely, a reorganization that was authorized after this matter had gone through the Federal Court, under Chapter 10, do you still say you would not grant it a license to operate in West Virginia?

Mr. Palmer: If your Honor please, Mr. Townsend, by his question is assuming the very question that we are try-[fol. 540] ing throughout this entire procedure, whether or not there can be a reorganization here, a reorganization out of whole cloth, and whether or not it can get permission to operate under the Investment Company Act of 1940; so that his question assumes—and upon any assumed basis of facts there must be substantial evidence to base the assumption or hypothetical question, and he assumes a fact which is the entire purpose of this hearing. I do not believe there has been any such proof made upon which a hypothetical question of that kind can properly be based.

The Court: The objection is overruled. (Exception.)

A. I don't understand what you mean when you put that verb in the past tense, or the past perfect tense—"was reorganized".

Mr. T. C. Townsend:

Q. Well, I will say "will be reorganized".

A. Organized by whom; and how much money will be put in it? I want to know that before I could answer that. I am not going to permit it to be organized on thin air.

Mr. Palmer: I object.

Mr. T. C. Townsend:

Q. You can answer it or not, Mr. Sims.

Mr. Palmer: I would like a little more explanation as [fol. 541] to what "reorganized out of whole cloth" means.

The Court: He said "new cloth".

Mr. Palmer: All right, I would like some explanation as to what that means before the witness answers.

The Court: That is clear enough. I don't think that requires any explanation.

A. I think it inadvisable to relicense the company to sell these contracts exclusively. Twenty-six of the biggest insurance companies in the last five years have lost $66,000,000 on annuity contracts.

Mr. T. C. Townsend:

Q. I understood you to say, Mr. Sims, that no matter if this Court would authorize a reorganization of the af-

fairs of this company, and vest in it authority to sell face amount installment certificates, you would not relicense it?

A. No, sir; but I might permit them to sell some face amount of contracts under certain conditions, if their principal business was insurance.

Q. And you think you have that authority?

A. I don't know; I would try it. They might make me license them, I don't know, but I would find out. That is the way you lawyers learn things.

Q. Well, Mr. Sims, you filed a petition in the Circuit [fol. 542] Court of Kanawha County, did you not?

A. Yes, sir.

Q. You filed that under the statute which gave you the right to do it?

A. Yes.

Q. In that petition, you asked for dissolution or reorganization, did you not?

A. Yes, sir.

Q. You proposed, when you filed that bill of complaint, to reorganize the affairs of this association through the Circuit Court of Kanawha County?

A. That was what I had hoped to do.

Q. Then you do think it can be reorganized?

A. Not as an annuity company alone.

Q. Part annuity?

A. I have serious doubts about the annuity business in any form.

The Court:

Q. How did you intend to reorganize it through the Circuit Court, Mr. Sims?

A. I don't know; I am not a lawyer, Judge. I had hoped to work out a plan and submit it by mail to the contract holders.

Q. What sort of plan had you hoped to work out?

[fol. 543]. A. Well, that was very thin and nebulous.

Q. Suppose you give it to us, however thin and nebulous it may be.

A. I thought the company could be mutualized and turned over to the contract holders, give the stock to the contract holders; it ought to belong to them because there is nothing left there for the stockholders.

Q. Do you think there would be any more trouble about doing that in the Federal Court proceeding than in the Circuit Court?

A. I don't know; I am not a lawyer.

Mr. Palmer: Your Honor, it has been called to my attention the fact that the West Virginia Legislature, in 1941, repealed the Annuity Company Law, being Article 9 of the insurance laws, Chapter 31 of the code, and that, therefore, the hypothetical question Mr. Townsend is asking would be impossible of performance.

(Off-the-record discussion.)

The Court: If you find that to be the case, that can be brought in in the briefs.

Mr. T. C. Townsend:

Q. When did you decide to institute this suit in the Circuit Court of Kanawha County, Mr. Sims?

[fol. 544] A. Well, do you want the whole truth, Mr. Townsend?

Q. That is what you are sworn to tell. You would not tell anything else, would you?

A. All right. In conference with representatives of the company, I told them I wanted to go over the records.

Q. Who were the representatives of the company?

A. Mr. Arthur B. Koontz.

Q. Anybody else?

A. He was in my office. I told him I wanted to go over the records.

Q. Anybody else?

A. No, sir.

Q. All right, then, go ahead.

A. I wanted to check the company. I had ordered them in November or December, on the 20th of the month, to trustee all their stock in the hands of disinterested parties, not politicians or anybody that owned any of the stock, or related to anybody who owned stock. They could run that thing at a profit. Well, they fooled along several months and did nothing, and never even honored me sufficiently to answer my letter, and I demanded the books be brought to Charleston for examination, and told them to pay for one of the examiners and I would pay for the other. I took a man [fol. 545] out of my office and retained the services of David.

Jayne here in Charleston, and they went to work on the assets of the company, and I discovered they had what I called "stolen" $480,000 out of that company, and handed it out to that "gimme" gang all over the U. S. A., and I got mad and cussed a little, which I have not done more than two or three times in my lifetime.

The Court: Do you mean you have not gotten mad more than two or three times in your lifetime, Mr. Sims?

A. I have been mad, but never cursed; and I made up my mind that something was going to happen, and it has happened.

Mr. T. C. Townsend:

Q. Well, what did you advise Mr. Koontz to do?

A. I told him I was going to bring suit.

Q. Did you talk to any other officials of the company, any one other than him?

A. No sir; I told him to call them up. He was the only one who seemed to have any ethics or honor here in this matter.

Q. And you told him what?

A. Well, I told him I was going to bring suit. Now, Tom Foulk was always honorable, of course, but he was sick. [fol. 546] Q. You told him you did not want anybody to have anything to do with the prosecution of the suit that had anything to do with the company?

A. That is what I told him.

Q. Is that what you told him?

A. Yes, sir; I told him I was going to get out that gang up there, that they were a bunch of robbers.

Q. Why wasn't he one of them?

A. He had been fighting with me all these years.

Q. But he did belong to the company, didn't he?

A. Did Mr. Young belong to the company? They were in the minority, and couldn't get them to do anything, of course.

Q. Then, there was a fight in the company, and you were with the minority, and the others would not let the minority do what it wanted to do; is that right?

A. I was against the robbers, and they were for them. That is the gist of it; if you want it in old fashioned English.

Q. Who filed your suit down here for you?

A. Oh, I went to the Attorney General's office, Mr. Partlow.

The Court: Mention has been made of some attorney [fol. 547] who got $92,000 from this company. I want to know who that attorney was.

Q. Can you tell me that, Mr. Sims?

A. I don't know, Judge.

Mr. T. C. Townsend: Mr. Sims can probably get it from the record, your Honor.

The Court:

Q. Will you find that out?

A. Mr. Marshall is here; I don't know whether it is in the records or not. I would like to say one thing, if the Court will permit, however. One of the directors who met in Pittsburgh has been living in property belonging to that company and has owed a large amount of rent for it, and there were some rubber checks in the till of the company. I don't know whether they were paid or not, from that same party.

Q. Who is that?

A. Jack Marshall.

Q. How much did he owe?

A. I don't want to state for fear I might make a mistake about it.

Q. Approximately? Was it a large amount?

A. It runs in my mind it was $1400 rent, maybe $2400, I don't know; and there were eight or ten bad checks in the [fol. 548] till of the company.

Mr. T. C. Townsend: Your Honor, that information about the attorney was handed me as coming from the books of the company. I think there will be a witness here as to that.

The Witness: My impression is, it was an aggregate of sums paid various attorneys in many states. I don't know. That was never revealed to me; but that is another thing that needed attention, if that is true, Mr. Townsend.

Mr. T. C. Townsend: I am not defending it. I am just calling your attention to it. Now, in the year 1938 there was paid $7,043.72; in 1939, $53,634.61; in 1940, $28,022.82; in 1941, $2,940.68, making a total of $92,041.83.

Mr. Fleming: Your Honor, I think Mr. McNulty would probably know of that, or some of the other employees from Wheeling.

Mr. T. C. Townsend: Well, I have no objection to handing this paper to the Court, if your Honor would care to see it (handing paper to the Court).

The Court: All right; we will recess now until seven o'clock.

Thereupon, at 5:15 o'clock p. m., a recess was taken until 7 o'clock p. m.

[fol. 549] Evening Session

The hearing was resumed at 7 o'clock p. m. after recess last noted.

Present—the same parties as heretofore noted.

Mr. Farmer: If the Court please, before adjourning Mr. Townsend was asking about some attorneys' fees, and I did not see the materiality of it, but he had a sheet of paper, which I believe he handed to your Honor. I wonder if I could see that sheet of paper.

The Court: Yes, sir, unless it is confidential to Mr. Townsend.

Mr. Townsend: Your Honor, I said there might be a witness on the stand later who would develop it. Until it is developed, I don't think it should be gone into.

The Court: Well, I am going to ask a question, and get an answer to it before we get through, so that may serve your purpose.

Mr. Farmer: I just wanted to see what the Court was seeing, was all.

The Court: If Mr. Townsend wants to show it to you, it is all right with me.

Mr. T. C. Townsend: I am not offering it in evidence [fol. 550] yet. You will get the result of it before the case is over.

Mr. Farmer: I am making the request that I be allowed to see it.

The Court: You are not going to be allowed to see it unless counsel wants to show it to you. He handed it to me and I have seen it, and I judge it is a private paper with him; but if he wants you to see it, that is up to him.

Mr. Farmer: I may be in error, but I cannot conceive of papers that counsel on the other side of a law suit hands to the Court are private papers.

The Court: I have told you that I am going to develop this in the course of the examination. That is all I care to hear about it just now. You will please take your seat, Mr. Farmer. (Exception.)

Mr. T. C. Townsend: Your Honor, I want to ask Mr. Sims a few more questions.

Q. Mr. Sims, this afternoon there was a paper here which contained a number of licenses, which had been issued by your office to Fidelity Investment Association to sell insurance, about twenty of them.

A. Twenty-one, I believe.

Q. I will ask you if it is not a fact that those licenses were all returned to your office without being used, and the [fol. 551] five dollar fee paid for each license was refunded by you to Fidelity.

A. At least I ordered it refunded. I assume it was done, because things are usually done which I say shall be done.

Mr. Lauritzen: Was your question directed to those salesmen's licenses?

Mr. T. C. Townsend: Yes.

Mr. Reinhardt:

Q. May I ask: those licenses were issued to the salesmen, not to the company; is that right?

A. The company asks for the licenses for the salesmen; all insurance companies do that. We place the burden on the company to apply for the licenses.

Mr. T. C. Townsend:

Q. These securities that are in your office, or in the Treasurer's office, that you testified about this afternoon; since the institution of the suit here in this Court on June 6, 1941, who, if any one, has been clipping the coupons from the securities?

A. I don't believe anybody has.

Q. Did any one clip the coupons from these securities between April 11th and June 6th, and if so, whom?

A. Perhaps so; but you would have to develop that from the clerks in my office, Mr. Brown and the man in the Treas-

[fol. 552] urer's office. If I understand what you are driving at, you want to know the transactions taking place between the company and the State in that interval? There has been half a million dollars deposited in the Treasurer's office in that interval, but that was in consequence of an agreement with Mr. Young. He withdrew certain securities before I asked for the receivership, and obtained them on the promise that they would be replaced, and he sold them and put new ones in their place.

Q. That was before the receivership took place?

A. No, it was after I had asked for a state receivership here.

Q. That was during the state receivership?

A. Yes.

Q. And during the state receivership, your recollection is that the coupons were clipped?

A. That is my recollection; I might be wrong.

Q. But since June 6th, the time the suit was instituted which brought the matter to this Court, there have been no coupons of any kind clipped?

A. I think not.

Q. Do you know Mr. Young, who is connected with the Fidelity?

[fol. 553] A. Yes, sir.

Q. He advised you a good deal in connection with the securities of Fidelity, did he not?

A. Yes, sir.

Q. Do you have confidence in him?

A. I do. I would add that Mr. Young is not infallible, but he is as good a bond man as I know.

The Court: Mr. Townsend, I want to ask you, in view of Mr. Farmer's request of me, if you will please see that, before this witness is excused, you either prove by him or by some other person the matters referred to in your question about attorneys' fees.

Mr. T. C. Townsend: Who made the request; Mr. Farmer?

The Court: Mr. Farmer made the request, yes, that I show him a memorandum which you had shown me, which I refused to do because of the fact that you requested it not be shown to him. Now, I am asking you that, before the examination is concluded, you produce somebody that will testify about the matters contained in that paper.

Mr. T. C. Townsend: I think I asked this witness about it, and he said he didn't know of the payment of any such attorney fees.

The Court: He said he didn't know; but he might be [fol. 554] able to find out.

The Witness: I don't think so, Judge; because I don't think those things are itemized in detail. It might be found in the audit of last October.

Mr. T. C. Townsend: Your Honor, I will disclose the source of my information. That is the best I can do.

Mr. Farmer: All I asked was to see the paper.

Mr. T. C. Townsend: I will disclose the source of my information to Mr. Farmer's satisfaction.

The Court: Also I want to ask the Auditor this question.

Q. Mr. Sims, in the year 1939, according to Mr. Townsend's question to you, which I assume will later be shown by some sort of proof, there appears to have been a $53,000 fee paid to attorneys in one year. Did not that impress itself on you at all?

A. It certainly did. I don't know that I wrote any formal letters about it specifically, but I talked to the company officials about their extravagance.

Mr. T. C. Townsend: I have no objection to Mr. Sims telling who it was.

The Witness: I don't know, because I was trying to hold them down within their loading for commissions and ac- [fol. 555] counting. I don't know that.

The Court:

Q. Did you make no inquiries from them as to whom they had paid this $53,000 to for attorney's fee?

A. Perhaps I did at the time.

Q. Well, did they tell you?

A. I don't recall; perhaps they did.

Q. Do you think you would have forgotten it?

A. There have been so many discussions about attorneys' fees in New York and here in Charleston and Wheeling and elsewhere, that it is hard for me to remember particularly any specific information or any particular time that such information was given to me, because I have so many things running through my mind that I have to have something to nail it down to before I can remember it definitely.

The Court: All right; is there any further examination of this witness?

Mr. Palmer: Yes, your Honor.

Cross-examination.

By Mr. Palmer:

Q. Mr. Sims, to your knowledge is it not a fact that there was a suit in Detroit brought by the Securities and Exchange Commission against Fidelity, in which quite a num-
[fol. 556] ber of attorneys were engaged by Fidelity to do work for them in that suit?

A. I have some hazy recollection of that, yes, but as to the definite amounts or names of the attorneys, I don't recall anything about that at all.

Q. And is it not further a fact that in 1939 in the northern district of West Virginia, there was a suit brought attempting to have a reorganization or liquidation, or some such matter of the Fidelity company, at which time the suit was strongly defended by the company and carried to the Circuit Court of Appeals, in which a number of attorneys participated in behalf of the company?

A. I recall that suit.

Q. Is it not true, also, that there was between a year and two years' work done in trying to get the company registered with the Securities and Exchange Commission?

A. I don't know how much work was done, but it covered several months.

Q. And you don't know, or would not attempt to state what the services were that were rendered for these various attorneys' fees?

A. No, I am not a judge of attorneys' work, or fees.

Q. And I say you don't know, you didn't see their bills,
[fol. 557] or know what services they did perform?

A. No, sir.

Q. One other thing, Mr. Sims: Mr. Townsend, in asking you about attorneys' fees, got from you, in answer to that question, a reference to the high accounting fees as well, and he said he was not interested in that. Will you tell us about the accounting fees which you protested about?

The Court: I do not think he said he was not interested in it. He said he was not asking the witness about that at that particular time.

Mr. Palmer: I think that is right, your Honor.

A. Yes, I protested it verbally, that there were too many audits. I don't know whether it is one hundred and fifty or two hundred or two hundred and fifty thousand dollars in five years they paid for seven audits or examinations, but it was a huge amount, and I complained about that.

Q. There was as much as seventy-five and eighty thousand dollars paid in one year for auditors' services; isn't that right?

A. Now, I don't want to testify to amounts for I cannot say definitely. I would have to have something to refresh my recollection by, but there were enormous fees paid to [fol. 558] auditors.

The Court:

Q. Who were those people that got that money?

A. Well, at one time they had Wilson & Cross of Cleveland. It runs in my mind that they got about $19,000 for that audit. I appeared up there at Wheeling when the case was on in Wheeling. That is how I know the name of that company. Now, I don't know whether it was Price-Waterhouse or not—don't know whether they examined them or not, but there was another firm that I remember.

Mr. Palmer:

Q. Mr. Sims, I will ask you if you recall this: that after a very expensive audit was made by the company, the Securities and Exchange Commission refused to accept that audit, as not being independent, and required another complete audit immediately following.

A. That is the information I had, yes.

Mr. Palmer: If the Court please, I have not objected to this question of attorneys' fees and audits, but I think it either ought to be gone into fully, or not gone into at all. I cannot see the relevancy of this; but if there is any purpose in it, I would be glad to have it come out now and I would like to have it gone into at this time; but otherwise, I think both the attorneys' fees and the auditing fees are improper [fol. 559] matters within the issues here, and I don't think they should be gone into. I think it is both a waste of time and irrelevant.

The Court: You have heard the Court's request to know certain information. If you have that information, I would be glad for you to tell me.

Mr. Palmer: I do not have any information about either the attorneys' fees or the auditing fees, and I never heard anything about it until Mr. Townsend mentioned it here. Of my own personal knowledge, the first I heard of it was here; so, as I say, I don't think it is relevant and, in fact, I would like to move to strike it out, unless the Court does see something in it where it should be developed as bearing on this question before the Court. If the Court does think it is relevant to go into that matter of attorneys' fees, I do not want to object to it, of course.

The Court: I will overrule the motion to strike, if there is a motion. I want it fully developed.

Mr. Palmer: Very well, your Honor.

Mr. Farmer: For what purpose, if the Court please, is it relevant?

The Court: I have ruled on the matter, Mr. Farmer.

Mr. Farmer: I did not hear your Honor's statement. [fol. 560] Does your Honor think it is relevant?

The Court: Well, the Court does not need to explain all his reasons for letting in or keeping out testimony. I have explained that I want this matter fully developed, and I think you understand why I do want it fully developed, because of a certain question that was propounded by you to the Court.

Mr. Farmer: Your Honor thinks I understand it?

The Court: Yes, because you requested me to give you a paper which Mr. Townsend handed to me, and you then made the statement that you thought you were entitled to see any paper the Court was entitled to see. Now, I say that you are entitled, and so am I, to have the matters fully developed that were contained in that paper; but I did not show you the paper because it was handed to me by Mr. Townsend, and I handed it back to him.

I think we may go ahead with the examination of the witness now.

Mr. Palmer: If the Court please, may I suggest, so that this matter can be developed correctly, that such books of the company, as are needed to show both the accounting and legal fees, be produced, together with a witness who knows the amount of work that was done by both the ac- [fol. 561] countants and the attorneys, so as to be able to judge whether the fees charged by both were fair and reasonable, or otherwise.

The Court: I suppose that would have to be done by Mr. McNulty, or some one, yes.

Mr. T. C. Townsend: Your Honor, I think there is a witness here who can develop this in a short time.

The Court: All right; let us proceed. Is there any further cross-examination of this witness?

Mr. Jaegerman: Your Honor, I would like to ask him a few questions.

The Court: All right, you may proceed.

By Mr. Jaegerman:

Q. Mr. Sims, I have in my hand Exhibit No. 21 in this case which is a mimeographed copy of a bill of complaint which was filed in the Circuit Court of Kanawha County, West Virginia, in the case entitled, "Edgar B. Sims, Auditor of the State of West Virginia, etc. against Fidelity Assurance Association, a Corporation". I show you this exhibit and ask you if you are familiar with it generally,

A. Well, I cannot tell without reading all of that and comparing with the original, because it is not signed by me.

[fol. 562] Q. I show the affidavit, which is an exact copy except that it is printed, of the one you signed.

A. Of course, this is typewritten in, my signature.

Q. It is a mimeographed copy.

A. I assume that it is authentic, but to say that every page is authentic without comparing it, I could not.

Q. Mr. Sims, I will have to ask you to read this bill of complaint, and tell me whether it is the same as the original that was signed by you.

A. Well, it would appear to be a copy of the bill, yes, from examination.

Q. Mr. Sims, are the facts contained in this bill of complaint true as of April 10, 1941, the day you signed and swore to this bill of complaint?

Mr. Lauritzen: Just a moment. I think there is an objection. If the purpose is to make this witness the witness of Mr. Jaegerman, to establish those facts, I don't think he should establish those facts en masse and as a whole, because we would have no opportunity to cross-examine as to those particular facts that he wishes to demonstrate.

Mr. Jaegerman: You will have all the opportunity in the world to go into that. This is an exhibit. It has been [fols. 563-564] in evidence for some time.

The Court: Overruled.

(Exception.)

A. They are substantially correct.

Mr. Jaegerman:

Q. Mr. Sims, are they substantially correct and true as of today?

Mr. Schurr: I think there is an affidavit on the last page of that which states upon what information and belief he made that affidavit. I think that speaks for itself. It states he made it upon information and belief.

Mr. Jaegerman: I don't think it says that at all. It says that the facts contained therein are true, except as to those facts alleged on information and belief, and the witness believes those to be true.

The Court: The objection is overruled.

(Exception.)

A. Yes, sir.

Mr. Jaegerman: Your Honor, I now offer in evidence for all purposes, Exhibit No. 21. I have no further questions of this witness.

* * * * * * *

[fol. 565] Cross-examination.

By Mr. Palmer:

Q. Mr. Sims, I believe you stated earlier that the Attorney General acts as your official attorney; is that correct?

A. Yes, sir.

Q. And that it was his office that had prepared this bill for you to file in the requirements of your statutory duty?

A. Yes, sir.

Q. And you are testifying that the facts of which you have knowledge, as therein contained, are correct to the best of your knowledge and belief?

A. Yes, sir.

Q. Now, isn't it also true tht in the state court proceeding there was no one who appeared in objection to that

proceeding, except one contract holder and no others, during the two months that it was in effect?

[fol. 566] A. I heard of only one contract holder that objected.

Q. You don't know of any more than one contract holder that appeared in objection to that bill in the State of West Virginia?

A. No, sir.

By Mr. Farmer:

Q. Mr. Sims, you were asked concerning a copy of this bill. Now, your affidavit of verification to this bill states that the facts and allegations therein contained are true except so far as they are therein stated to be no information, and that so far as they are therein stated to be on information and belief you believe them to be true. Now, I am asking you, is it a fact that some of these allegations are made of your own knowledge and others are made on information?

A. It may be and it may not be; I don't know, because the bill was worked on so many times by Mr. Partlow, the Assistant Attorney General, and there were certain revisions to be made and so on, so I don't know, without refreshing my recollection, about that definitely. Perhaps it would require a great deal of time to check the sources of information contained therein.

Q. You say it would require a great deal of time to check [fols. 567-575] the sources of information?

A. Yes, because we had to do a lot of checking.

Mr. Reinhardt:

Q. Well, Mr. Sims, in so far as the allegations in this petition are based upon information, rather than knowledge, that is set forth in the petition, is it not?

Mr. Schurr: What page are you referring to there?

Mr. Reinhardt: Page 5.

A. Yes, on page 5 it is stated there about the number of shares outstanding. I had to trust to some of the clerks, and perhaps others, to get the information on the number of shares and contracts outstanding. I did not have that information in the office.

The Court:

Q. The question is, as I understand it, where you made allegations upon information you have so stated in the bill of complaint?

A. I think so; yes, sir.

* * * * * * *

[fols. 576-577] Q. You would not permit them to have any subsidiaries that were not properly managed and conducted, would you?

A. How can the poor Auditor of the State of West Virginia help himself?

Q. Well, were their securities deposited with you?

A. Yes, sir.

Q. Well, you did your best to keep those securities——

A. (Interposing:) I advised against it.

Q. (Continued:) —as clean as possible, and in accordance with the law?

A. I stormed against the subsidiaries.

Q. Well, you have endeavored to keep the portfolio as clean as possible, have you not, and has it not been kept clean?

A. Well,——

Q. Cleaner than most portfolios?

A. Well, it has been cleaned up to a great extent by Mr. Young's buying and selling better grade securities.

* * * * * * *

[fol. 578] Q. Mr. Young and you had been largely responsible for the purchase of those bonds or securities, had you not?

A. Well, the kind he bought did not drop so much, because he had been buying higher grade ones.

Q. But they had dropped?

[fol. 579] A. A good many of them did.

Q. And no one was responsible for that except the drift downward of securities?

A. No.

Q. Now, you particularly mentioned Mr. Messick; and you said Mr. Messick, I believe, drew a large salary, $12,000 a year?

A. Yes, sir.

Q. Do you know over what period of time he drew that salary?

A. No, sir.

Q. Do you know that Mr. Messick only drew about $3500 in all, out of the company, during the several months that he was with the company?

A. Whatever he drew, he drew too much, in my judgment.

Q. You don't like Mr. Messick, do you?

A. I don't like any man who promises to give half a million dollars and then reneges on it.

Q. Do you know that he never promised to give half a million dollars?

A. He told me he was unable to get the money after he agreed to get it, so he must have.

Q. Do you know that Fidelity did not do the thing that [fol. 580] it promised to do?

A. No.

Q. And don't you know that that was the reason why that deal did not go through?

A. I don't know any such thing, no.

Q. Is that the only thing you have against Mr. Messick?

A. I have it in for any man who will welsh on his word.

Q. You say he welshed on his word, and he said he did not.

A. Well, let him bring his $250,000, along with Mr. Rosset's, and put it up, and see if he means business. He never had any $250,000 to put up. I have checked on it.

Q. You have said that the organization apparently, during that period, was very bad and you could not hardly find language sufficiently strong to describe it; is that right?

A. Yes, sir.

Q. Do you have some one else in mind other than Mr. Messick?

A. Everybody that had anything to do with kiting salaries, making advances to salesmen in large sums, which they had not earned.

Q. Who did that?

[fol. 581] A. The majority of the directors. Do you want to know some of them? I can name them.

Q. Yes, name them all.

A. I can name most of them, not all of them from memory: Mr. Reed, Mr. Evans, Mr. Pulfer, Jack Marshall, John Marshall—I don't know who else, I cannot recall right now.

Q. So far as the securities end of the business was concerned, that went along all right during that period except there was a downward trend in values; isn't that right?

A. Nothing wrong with the handling of the securities, as far as I know.

Q. The waste that occurred, you say, was in the management, and in the sales department?

A. Yes, I kept telling them to cut out their expensive offices all over the United States.

Q. And it was in the home office management?

A. Yes, sir; and they would come to me and tell me they were going to do that, that they were just cutting them off as fast as they could, but that they had to maintain these offices during the life of the contract, and a lot of sales propaganda like that, and when it was closed [fol. 582] they still had in Chicago a suite of rooms costing $9,000 a year.

Q. How much would you say was wasted in the management of Fidelity from the end of 1937 to 1940?

A. Well, their records which I examined over here, two experts working on it, show they made an advance of $480,000 in excess of commissions earned and collected.

Q. There has been something said about attorneys' fees—First, let me ask you this: you did not check to see how much Mr. Messick had received, did you?

A. No, sir.

Q. Now, there has been mentioned something about attorneys' fees and auditors who received tremendous sums. You did not check to see what those were, did you?

A. At one time I did check over that.

Q. It has been mentioned that large sums, something like $93,000 was paid out to the lawyers alone in that period. You did not check that either, and you did not know then, and you don't know now to whom that money was paid, do you?

A. Perhaps at that time I did, and perhaps I asked about it, or checked it, because we discussed at length in our office their huge expenditures.

[fol. 583] Q. Do you remember any one else except Mr. Messick that you say was responsible for some of the huge expenditures during that period?

A. Everybody that had anything to do with the voting of that money out.

Q. Can you give me the names of any of the ones that were directly responsible for that?

A. Well, Mr. Risley was president.

Q. You could name him as being one responsible?

A. He was president of the company and he was in my office just before—along during that time, and I landed on him about the four hundred thousand dollars, and he said it was mathematically impossible to run the company on the loading, and I told him it was useless to try to continue the company as it had been going, or I didn't know any mathematics, one or the other.

Q. Now, at the time you filed this suit for receivership in the state court, here in Kanawha County, you filed that in your official position, as you felt at that time it was possible to bring about rehabilitation and reorganization of the affairs of the company, did you not?

A. I did it for the express purpose of stopping the wasting of the money that belonged to the contract holders.

[fol. 584] Q. In other words, you say you brought that suit for the purpose of obtaining control of the affairs of the company.

A. For the purpose of exploration, and to reorganize it or liquidate it, whichever it was necessary to do under the facts.

Q. You had been insisting on having people discharged who had abused their official positions, had you not?

A. Yes, sir, but it did not do any good. I did not get the right ones, or enough of them, I could not tell which.

Q. They were under your complete control?

A. I would like to see anybody in the world control a bunch of incorrigibles like that.

Q. You continued to permit them to do business in the State of West Virginia, and permitted them to go throughout America, and sell these securities throughout America. did you not?

Mr. Palmer: Your Honor, this witness has nothing to do with any place outside of the State of West Virginia. I think this is going a little too far when he goes "throughout America", and I think that should be stricken out.

[fol. 585] Mr. Fleming: He said he had something to do with that, and he evaluated their securities as a whole.

The Court: I think the witness may answer that, if he does have anything to do with it.

(Exception.)

Mr. Fleming:

Q. Do you have anything to do with it?

A. What is the question now?

Q. You continued to permit them to do busines in the State of West Virginia, and permitted them to go throughout America and sell these contracts throughout America; didn't you.

A. Well, we permitted them to do business.

Q. And you did that, knowing all these facts concerning which you have testified?

A. Yes, they would tell me they had reformed, but when they reformed they did not stay reformed.

Mr. Fleming: That is all, your Honor.

Recross-examination.

By Mr. Palmer:

Q. Mr. Sims, you were talking about these so-called "pups" or subsidiary companies. Does the name Marston Company refresh your recollection?

A. Yes, that was one.

Q. How about the name Marietta Company?

[fol. 586] A. Yes.

Q. How about the Paull Company?

A. Yes, that was another.

Q. Were those companies used to hold real estate?

A. Yes, they were used to hold the real estate of the company.

Q. Who held the stock of those companies?

A. The parent company.

Q. They did not put it into any of the funds as securities deposited?

A. I think some of those companies owned some bonds that were deposited to various accounts, real estate mortgage bonds, utility bonds, railroad bonds and the like.

Q. By the statutes of West Virginia, how far does your authority go over these companies, such as Fidelity, other than closing them up when they are insolvent?

A. I would like to know that, myself.

Q. Has there been some question as to the interpretation of the laws of West Virginia, as to whether or not you were legally entitled to crack the whip on them?

A. There has been some question about it, yes.

Q. And you have gone as far as you felt you could go legally, and even further because it was morally necessary [fol. 587] to do all you could?

A. I have gone further than decency and respectful bearing would dictate a man should go at times, in scolding them, commanding them and demanding. I have gone so far as to call them thieves and a bunch of brigands.

Q. Mr. John Marshall, to your knowledge, was one of the large stockholders of the company; isn't that right?

A. Yes, sir.

Q. Did you talk to him about trying to control these men so as to protect his investment as a large stockholder?

A. I think I did on one or two occasions, one at least.

Q. And what was the purport of that conversation?

A. The occasion was when it was before the SEC, when there was a hearing before the SEC in Washington. He came to me and besought me to permit this man, this great man Messick, to continue with the company; and I told him he had more to lose, or his family did, than any other stockholder in the company, and as far as I was concerned, Mr. Messick was out and was going to stay out.

Q. And you were doing that under your official duty as Auditor and not because of any personal feeling you had for Mr. Messick?

A. No, sir; under my official capacity and not dealing [fol. 588] in personalities.

Q. Did you know Mr. Messick personally except through your official duties?

A. I never saw Mr. Messick but twice until today. I saw him twice before today.

Q. And both of those times were on official business, so far as you were concerned?

A. Well, he came to my office after he was out; or he was in the Insurance Department when I walked in and Mr. Justice introduced us and I acknowledged the introduction and walked across the room, turned and came back and told him he was out and was going to stay out; that he had promised to put up half a million dollars and did not do it, but instead attached himself to the payroll at $1,000 a month; that he did not come to fetch the money, but he came to get the money, and that he was out and was going to stay out as long as I was Auditor of the State of West Virginia, and I mean it.

Q. I believe the record does not disclose, but since your first election as Auditor of the State of West Virginia, and since you took office then, you have been continuously in office, and have been reelected to that same office twice at four-year intervals, by the people of the State of West [fol. 589] Virginia?

A. Yes, accidentally so.

Redirect examination.

By Mr. Fleming:

Q. Mr. Sims, you have a difficult position, I think we will all agree, but do all these companies that you supervise, have they all been as difficult to control as Fidelity?

A. No, this is the roughest bunch I ever got hold of. You can't save them from their own folly, in wasting their own money.

The Court: Is there any difference in principle, Mr. Sims, between the large salaries paid to the officers of the company and the large fees paid for legal services and for auditing services? Is there any difference in principle in those things?

A. Both of them show incompetency on the part of the management and lack of mathematical sense, your Honor.

The witness was then excused.

[fol. 590] H. Isaiah Smith, being recalled as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name, please.

A. H. Isaiah Smith.

Q. Where do you live, Mr. Smith?

A. Charleston.

Q. What is your business?

A. Do you mean at the present time?

Q. Yes.

A. At the present time I am employed more or less in a managerial capacity by the Central Trust Company, Trustee for Fidelity Assurance Association, at its home office.

Q. As I understand, you have been in the banking business and other business?

A. Yes.

Q. And you have especially fitted yourself to handle financial matters, have you?

A. Well, my training has been in financial lines, and my experience.

Q. Now, since June 6, 1941, or a day or two after that, as I understand, you have been employed by the Trustee, [fol. 591] the Central Trust Company, in this proceeding and have been generally in charge of the affairs of Fidelity?

A. That is right.

Q. Now during that period, as I understand, you have been engaged in making a general survey of the affairs of Fidelity, have you?

A. Well, most of our time has been taken up in the office in preparing reports for this hearing.

Q. You prepared the reports for this hearing and the reports that were filed yesterday morning in court by the Trustee, as I understand, each of those were prepared under your supervision; is that right?

A. Yes, sir.

Q. What reports were those, briefly and generally?

A. A balance sheet showing the book assets and book liabilities by funds as of June 6, 1941,——

Q. Do you have that balance sheet with you?

A. It was filed with the Trustee's report as an exhibit yesterday. I could identify it. Then there was a list of creditors, that is, the contract owners, and a list of the names and addresses of the holders of common stock and a list of the names and addresses of the holders of preferred stock.

[fol. 592] Q. And the amount held by each?

A. And the number of shares held by each, and the list of unpaid bills as of June 6th; a list of outstanding checks, and then a schedule showing the market value as of June 6th of the securities held by the various funds.

Q. Does that show the location of those securities, Mr. Smith?

A. The state in which located, yes.

Q. Do you have that available?

A. It is filed with the Trustee's report.

Q. Is that in the Clerk's office?

Mr. Townsend: It is right there in that file.

Mr. Fleming:

Q. You may proceed, Mr. Smith.

A. From my recollection that covers the contents of the report of the Trustee filed on yesterday, the various exhibits.

Q. You mentioned the list of contract holders. Can you tell the Court the number of contract holders in Fidelity at the present time?

A. I think it is approximately 80,000; maybe it is a little less.

Q. And distributed over how much territory, would you say, Mr. Smith?

[fols. 593-604] A. Over practically every state. They are not broken down by states, you understand, but I should think that the addresses from that list would reveal owners of contracts in probably every state in the Union.

Q. And in Canada?

A. Possibly in Canada.

Q. And in foreign countries also?

A. Possibly so. I am saying you would have to make an examination to reveal that. I did not examine it from that standpoint, however.

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[fols. 605-606] Mr. Fleming:

Q. Mr. Smith, you came into the affairs of Fidelity as one of the receivers in the state court proceeding, as I understand?

A. That is right.

Q. And you have been in this work since April 11, 1941?

A. Yes.

Q. Were you employed in any capacity with Fidelity prior to that time?

A. No, sir.

Q. But since that time you have given practically all your time, have you not, to the affairs of Fidelity?

A. I have. That is, I have as one of the receivers and then as an employee of the Trustee.

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[fol. 607] Q. From the knowledge which you have gained in this position in which you have been working, and from

your general experience and knowledge, I will ask you whether in your opinion it is possible to have a rehabilitation or reorganization of Fidelity.

A. That has been my only thought since I have been appointed by the state court.

Q. You feel that can be done?

A. Yes; and of course, during the trusteeship I have been doing such work for them as they desired to have done.

Q. In other words, during the state court receivership your activities were partially directed at least towards considering the working out or developing of a plan of rehabilitation?

A. Of course, we did not have time to get to it but that is [fol. 608] what we did have in mind, definitely.

Q. And you still have that in mind, have you not?

A. Yes.

Q. Do you think it could be done?

A. My personal thought?

Q. Yes.

A. Without attempting to qualify as an expert, and without attempting to say what sort of plan, in my opinion with the assets the size that Fidelity has, a reorganization of some sort can be done.

Q. From your contact with the contract holders, what would be your judgment in reference to working out with them a reasonable and equitable plan which would protect the rights of the contract holders?

A. Such contacts as I have had, the contract owners are in a fairly good frame of mind. I mean by that, that a great many—I am not trying to give any percentage but a great many—have indicated a desire to see a reorganization.

Q. Do you feel there is a place for Fidelity in the business world and for its rehabilitation and continuation?

Mr. Palmer: I object, your Honor, because the question asks is there a place for Fidelity. I don't think he means that. I think he means for the sort of company—for some [fol. 609-626] sort of company, and I would rather he would state some sort of company, whatever he has in mind, than Fidelity, just using that description for whatever may be reorganized.

The Court: Well, it depends on what he does mean. If he means there is some good will attached to the name,

then the question is proper; if not, I think it ought to be framed otherwise.

(Question read to the Court.)

The Court: The objection is overruled to that question. (Exception.)

A. In my judgment a company selling such forms of investment contracts as Fidelity has in the past would have a rather difficult time in that same form of contract. Now, with probably a modified type of contract sold or attaching to it some other feature to fit into the economic period we are in now, why, I would say without qualifying my answer that it would be possible.

* * * * * * *

[fol. 627] Q. I was speaking of the company as a whole and not attempting to allocate them to the various funds.

A. Yes.

Q. Now, with reference to reorganization, I think I copied your words down when you said you believed reorganization of some sort can be done. Is that substantially what you said?

A. Yes, that is a pretty broad term, I expect.

Q. Now, you have had some two months' experience as a state court receiver, and have had approximately the same time as an employee of the trustee in this proceeding; is that not right?

A. Yes.

Q. As such you have had some little chance to study the working of Fidelity although your main employment has been in trying to gather the various funds together and to get reports up on them.

A. That is right.

Q. Now, when you say reorganzation of some sort can [fol. 628] be done, you are using that purposely in a very broad sense, are you not?

A. I am.

Q. You are not attempting to state you believe there can be 66⅔% of the creditors or contract holders, either as a whole or of any one class, who can or will agree to any specific plan, are you?

A. Of course, I could not answer that question without knowing something about the plan. I don't know what

they are going to do, and even any kind of plan we might finally think is good I don't know who will accept it and who will not.

Q. It is your conviction, is it not, Mr. Smith, that with the present economic situation and the present yield that a company can get from investments in stocks and bonds, that any company has difficulty in making as much as 3% yield net on its investment; isn't that right?

A. You say, as much as 3%?

Q. Yes.

A. No, some of the life insurance companies are improving their reserves, I think, 3½%. I cannot qualify as an expert on this but it is my understanding some of the investment trusts are having a yield probably in excess of 3%—earn a yield in excess of 3.

[fol. 629] Q. Let me put it another way, Mr. Smith: I believe you said on your direct examination that you did not believe at the present time that face amount securities could be sold profitably by any company which could be reorganized at the present time; is that correct?

A. I believe I qualified it by saying a company that attempted to sell exclusively face amount certificates probably would have some tough sledding.

Q. One of the reasons they would have difficulties would be in the requirements of the Investment Company Act of 1940; is that right?

A. I am not familiar enough to talk about that.

Q. Do you know whether or not such a company would at the present time have difficulties in qualifying and getting licenses from the various proper legal bodies in the various states in which they would attempt to go?

A. I wouldn't know how to answer that.

Q. When you were a state court receiver, or during the period in which you were exclusively a state court receiver,—you may still be, Mr. Smith—but from April 11 to June 6 isn't it a fact that you had this thought in mind, that even if 40% or 50% of these persons who had the approximately $25,000,000 fund could be gotten together to [fol. 630] form some kind of an organization for their own benefit, that it would probably be to their best interests rather than a forced liquidation?

A. Any appreciable amount of—a concern with assets such as Fidelity, any appreciable number who could work out some scheme to keep from forcing those securities on

the market, certainly, I think, would reflect to their advantage. I say an appreciable amount. I would not want to fix the percentage.

Q. An amount large enough to make it worthwhile?

A. Yes.

Q. And was it not your idea that the best way that could be worked out would be through some form of life insurance company with perhaps the selling of annuities as a minor part of that?

A. Frankly, I had thought about a good many angles but to come down to saying what—to begin to talk about plans, I did not have time to do it.

Q. Mr. Smith, is it not true that in the state court proceedings in the State of West Virginia only one policyholder came in and protested against those proceedings, and that policyholder intervened only for the purpose of asking to be informed as to what the plan of reorganization would be?

[fol. 631] A. That is true.

Q. And did not come in to protest but came in and asked to be informed before anything was ultimately done?

A. That is true.

Q. In the letters you received at that time from contract holders, is it not true that the general tone was one of inquiry without criticism as to what was going to take place and how they were going to be affected by it?

A. Yes, I would say, of course, these people who have money invested are naturally just like we would be. They want to know what is going to happen. To analyze those letters with any degree of percentage as to what they say is hard to do. Here will be one that will say he doesn't want insurance; another will say he will go along; another will say he wants reorganization or something else, and it is pretty hard to classify a general answer as to that.

Q. Can you tell us from your knowledge of the workings of the company whether or not during the time since information has been given broadcast that the company is under a chapter 10 proceeding there has been a gradual diminishing of the payments by the policyholders into the offices of the company?

A. I would say it has been gradual since the first court [fol. 632] proceeding. I mean the April proceeding. There has been more or less gradual decrease ever since.

Q. And I believe it was approximately $280,000 that was paid in during that two months, and approximately $100,000 during the last two months, which shows about the ratio of decline in the payments by the contract holders over that period of four months' time?

A. That is what the record will show, yes, that we have collected during that period.

Q. I say, does that give a fair indication of the rate of decline of the contract holders to pay in under their contracts?

A. That is exactly what has happened, yes.

The Court:

Q. Mr. Smith, is it true or not that the contract holders have been advised, in effect, that their rights would be the same whether they continued to pay in or did not?

A. That is right. That is a quite interesting thing, if I am permitted to make an observation.

Q. All right, go ahead.

A. A very large amount of our inquiries will say they don't see any need of paying in if their interests are not going to be jeopardized, that they won't pay any more. [fol. 633] Now, that would account for the dropping off considerably in payments, I should think. To be safe, we advised them that, under the state court receivership, that is, their equities were fixed as of April 10, whether they paid in or not; and the Trustee has taken the same position that their equities were frozen as of that date and they would not lose their equities by stopping their payments.

Mr. Palmer:

Q. Mr. Smith, in the answer filed by the Auditor of the State of West Virginia, on page 22 thereof, there is a certain table or chart setting forth the various states in the left-hand column, and across the top it shows the various series of contracts or contract series of Fidelity, and in one column opposite the states named is an "L," indicating contract liability to contract holders residing in that state, and the letter "D" is used to indicate that securities belonging to the pertinent contract fund have been deposited in such state. Will you take that table and check it with the schedule of securities deposited by funds on

April 10, 1941, and see if it is not true so far as you can tell that that schedule on page 22 is correct?

The Court: Are not both of these papers in evidence already?

Mr. Palmer: The answer is in evidence, sworn to by [fol. 634] Mr. Sims. If I can have an understanding that no one will object to its accuracy, with the right, however, if they find it inaccurate to object to it, I will be glad to introduce this in evidence without anything further, your Honor.

The Court: What I am driving at is this: Is the paper with which you are asking to have the answer compared, also in evidence? Are not both of them in evidence?

Mr. Palmer: No, sir.

The Court: Can it be put in evidence?

Mr. Palmer: I am afraid not. It is a paper I could not very well prove but which has been made up and with which this witness is familiar and it will refresh his recollection.

The Court: All right.

Mr. Palmer:

Q. Is that correct?

A. Yes, sir, I can verify that schedule as being correct.

Mr. Palmer: Now we offer to introduce in evidence page 22 of the "Answer and Controversion of Edgar B. Sims, Auditor," etc. I think it is a part of the record but we want to introduce it now as being correct.

Exhibit No. 28 Filed

[fol. 635] Q. Mr. Smith, your answer is based upon information obtained by you, which has its source as the books of the Fidelity Assurance Association; is that correct?

A. Yes, sir.

Q. It is correct, is it not, that you and Mr. Ross B. Thomas were acting as state court receivers when this present proceeding was brought?

A. That is right.

Q. And were you gathering the assets as far as you were legally able to do so into your possession as such receivers?

A. That is right.

Q. And if there had been no reorganization were you and Mr. Thomas capable of going ahead and liquidating those assets and making such distribution as the Auditor would require?

A. You mean, the assets in our hands?

Q. Yes.

A. Oh, yes.

Q. And were you at all times working with the Auditor of the State of West Virginia on his part of the administration of the estate?

A. Yes.

[fol. 636] Q. And you were also working under the guidance and direction of the Circuit Court of Kanawha County, West Virginia, were you not?

A. Yes.

The Court: Mr. Palmer, there is one thing the Court would like to get straightened out in its own mind as to the position you are taking in this suit here. As I understand, you represented the receivers in the state court proceeding, and Mr. Smith as one of the receivers says that his whole thought in the matter was to try to effect a reorganization, and I presume that you as his attorney in that matter were one with him in that thought. Now, you are appearing here and from your questions it seems that you are endeavoring to prove that there is no possibility of any reorganization. That appears inconsistent to the Court and I would like to know what the explanation of that is, Mr. Palmer.

Mr. Palmer: I think that is a fair question and I will be more than glad to state my position on the record, your Honor. If the Court please, I understand this: that under this table just introduced in evidence as Exhibit No. 28 there are 15 different states which required deposits and 20 states where the debtor was required to obtain a license, [fol. 637] and there were some seven to nine different contract funds and series in these various states, so taking each one for one it adds up to a total of 117 classes of creditors. Now, it is my opinion that it is impossible at this time to obtain the consent of two-thirds of each of these classes of creditors to any plan of reorganization that can be presented. In the second place, it is my opinion that no plan can be formulated which this Court will approve which will have the approval of that number of

creditors. However, I do feel that there are a large number of contractholders who would prefer, as Mr. Smith and others have said, some form of company whereby periodic installment savings can be made; that they like the idea and are willing to continue it, and it is my personal belief as counsel, and having talked to some others about it, that if a group as large as, say, $10,000,000 or 40% would approve of such a plan, or 50% that in state court proceedings they voluntarily agree to that, that then an insurance company could be formed by their voluntary agreement which could do that; that, however, the Federal Court's hands are bound by Chapter 10 proceedings and unless two-thirds agree, even though 40% or 50% or 60% would agree, the Court would have to reject the plan, and I [fols. 638-660] sincerely feel and I think that the state court receivers feel that in state court, particularly prior to the bringing of this suit, there was every possibility and likelihood of a very substantial part, a large enough part to make it worthwhile, of these contractholders agreeing to some plan among themselves for voluntarily keeping this going and not having at the very last a forced liquidation.

The Court: Did you then, and do you now, consider that such a reorganization on the part of any percentage of the contractholders is beneficial to them?

Mr. Palmer: Yes, sir, I do.

The Court: Then your only doubt, and your only question, is as to the possibility of getting a sufficient percentage to agree?

Mr. Palmer: Yes, that is correct, your Honor.

* * * * * * *

[fol. 661] The Court: Either you misunderstand the allegation of the petition or the Court does, Mr. Farmer. I have been able to see nothing in the petition which says that any vested rights of any contractholders are to be modified or need to be modified. My understanding of the allegation of the petition is that the contracts, the executory contracts of the company, contain provisions that the company cannot meet, and that in order for any reorganization those executory contract provisions must be modified; but certainly there is no indication there that any vested rights in any deposits are going to be affected at all, and the Court would not permit that if there was any such thing contemplated. Whatever vested rights the contract-

holders have in any deposits are going to be protected right through this proceeding. Now, it is true we have not yet [fols. 662-674] got to the point of determining what those vested rights are. That will come at a later stage of the proceeding, but certainly they are not going to be divested in any way.

[fol. 675] Mr. Huwe: Another thing I would like to bring out, your Honor, I would like to have some testimony introduced as the financial standing of Fidel of New York, the purpose being since the question of reorganization is involved here whether this company can go on as a face amount certificate company. Now, if Fidel of New York is able to do such business, is in good shape, why cannot at least Fidel be organized on the same basis and condition? I think it is pertinent, and we have evidence with respect to that likewise, to show the feasibility of some plan.

Mr. Court: We will see about that later. Mr. Fleming will be here shortly, I understand.

Mr. Huwe: I take the attitude of representing certain creditors who may want reorganization. We want to investigate and see what is going on; although we filed pleadings denying the jurisdiction of this Court we have a right to examine the merits and I want to see both sides.

The Court: I will give you every right to develop your [fol. 676] position.

Mr. Gray: Your Honor, the issues are made up here by the answers and the petition. I wonder if we can proceed now to take the evidence upon our issues so that counsel from distances might get through?

The Court: The Court will look after that.

Mr. Gray: I realize that, your Honor, but I thought perhaps we were imposing on the Court a little.

The Court: I have been helped somewhat by the statements made and I will say that I want to get what light I can on the situation, at the same time we are going to hurry it along. I think you have all observed that I have been doing that. Are there any more questions of this witness?

Mr. Palmer:

Q. Mr. Smith, other than the deposit with the State of West Virginia in the City of Charleston, are there any

other assets to your knowledge of Fidelity in the Southern District of West Virginia?

A. Did you fix the date?

Q. As of June 6th.

A. Yes, there was some furniture, a small amount, I don't know the value, but a normal amount in the branch office here in Charleston, and I think some of the furniture was stored in Bluefield.

[fols. 677-679] Q. Let me rephrase it: Were there any other substantial assets?

A. In May the receivers had transferred some cash—opened accounts in banks here in the City of Charleston to the extent of about $380,000, I believe, approximately.

Q. That had been transferred by the receivers from other banks into the City of Charleston?

A. That is right.

* * * * * * *

[fol. 680] Mr. Farmer:

Q. Did you bring those copies of those letters or communications from the receivers and from the trustee to the contractholders that you were requested to furnish?

A. Yes.

Q. May I have those?

A. Do you want them from the stand now or when I am through?

Q. I would like to see them now.

A. All right (handing papers to counsel).

Mr. Farmer: Your Honor, I would like to introduce in evidence and have them marked certain letters. First, I offer this letter from Edgar B. Sims with reference to Fidelity.

Exhibit No. 29 Filed

The Witness: If the Court please, that letter just filed was sent out as an enclosure in a letter mailed out by the receivers.

Mr. Farmer: Which letter just referred to by the witness, I now offer as Exhibit No. 30, if the Court please.

Exhibit No. 30 Filed

Mr. Farmer: If the Court please, I now offer as Ex-
[fol. 681] hibit No. 31 a letter from the witness and Ross

B. Thomas, dated April 18, 1941, with a statement of the receivers attached thereto, as Exhibit No. 32.

Exhibits Nos. 31 & 32 Filed

Mr. Farmer: Next, your Honor, I offer in evidence as Exhibit No. 33, a letter from Central Trust Company, Trustee, dated July 3, 1941, which contains a notice from the Trustee dated June 26, 1941, together with a form of some sort, an application for return of payments, and a special notice attached. I offer those collectively as one exhibit.

Exhibit No. 33 Filed

Q. Now, Mr. Smith, were those all the form or circular communications sent out by the receivers or trustee?

A. That is right.

Mr. Reinhardt: If the Court please, with respect to Exhibit No. 32, may I inquire for what purpose that is introduced in evidence?

Mr. Farmer: I just wish to introduce in evidence all the communications from the receivers and the trustee to contractholders. There has been testimony here about what they wanted and what they said and wrote. I just want to show what was said to them.

Mr. Reinhardt: In other words, this is introduced in evi-[fol. 682] dence merely for the purpose of showing that such communication was sent?

Mr. Farmer: Just to show both sides of the conversation or communication.

Mr. Reinhardt: Do I understand you mean by that to answer yes to my question?

Mr. Farmer: I think I have answered the question.

The Court: You can answer that question. What is the use of burdening the record by a lot of unnecessary colloquy? Mr. Reinhardt wants to know whether the purpose of this is to show that these contract owners received that sort of communication, or for what purpose, if not for that purpose.

Mr. Farmer: Yes, to show they received them.

Mr. Reinhardt: Then there is no objection, your Honor.

Mr. Palmer: If the Court please, rather than ask a question to Mr. Smith, it may be by addressing myself to the Court I can save several questions. Am I correct in my un-

derstanding that the evidence introduced to this point has shown now that the liabilities to contractholders as promised by the debtor are greater than the assets that the debtor has in such an amount that has been proven; that there is no interest now and has been none of June 6th of the stockholders in the debtor corporation any longer in a [fol. 683] financial way?

The Court: That there is no what?

Mr. Palmer: Is no interest on behalf of the stockholders in the debtor corporation.

The Court: I think the evidence has shown that the company was insolvent. Mr. Sims' evidence shows that.

Mr. Palmer: Perhaps I had better ask a question then.

Q. Mr. Smith, from your records, is it not true that, as shown by the records of the company, the company has far greater liabilities to its contract owners than it has assets with which to meet those liabilities as of June 6th?

A. Mr. Palmer, does your question mean by funds or by the total of all funds and total assets of all funds and the total liabilities of all funds?

Q. That is correct, the latter part of it.

A. Based on the market value as of June 6th of the securities, and using the book value of other assets, some of which I feel reasonably certain are the books values in in excess of the market value, the total liabilities of all funds, including the general fund, is greater than the value of the total assets of all funds, including the assets of the general fund.

Q. By approximately how much money?

[fol. 684] A. That is difficult to answer, in that we have never made what you might say was a consolidated statement of the total assets and total liabilities, because we have always treated them by funds. We look on the solvency or insolvency by funds rather than the solvency or insolvency by total assets or total liabilities.

Q. Would the Auditor's statement of approximately two and a half million dollars be substantially accurate?

A. In my judgment it probably exceeds that a little bit.

Q. You have included in your total assets any and all capital and reserve of the company; is that correct?

A. Oh, certainly so.

Mr. Palmer: That is all, your Honor.

Redirect examination.

By Mr. Fleming:

Q. Are there funds of Fidelity that are solvent?

Mr. Palmer: What do you mean by "funds of Fidelity that are solvent"?

Mr. Fleming: I mean classes, for instance, Series B income contractholders, and Series D.

The Court: I gather the question refers to the funds the witness spoke of a few minutes ago in saying that he classi-
[fol. 685] fies the financial situation with reference to funds.

A. There is one reserve fund that I can say is solvent, yes.

Mr. Fleming:

Q. What is that?

A. Series D.

Q. That is the last fund, as I understand?

A. Yes, that was.

Q. As I understand it, Series C is also solvent?

A. The Series C is small.

Q. Only has one or two contractholders in it?

A. I think so. It has a liability of $600—approximately that, six-hundred-odd—cash in the bank of about four thousand and something. We don't think of Series C hardly as being in the picture. The only asset they have is cash of about four thousand.

Q. You only have out one contract at the present time?

A. I think so, yes.

Q. What about Series B?

A. When we get into Series B, I want to make this plain, there are certain of these assets here that I am not able to obtain the market value on, which would make it difficult to evaluate them. There are certain assets in Series B, real estate, that until I would have an appraisal as to what
[fol. 686] that would be; I would be unable to state the solvency or insolvency of that particular fund.

Q. It might turn either way, as I understand?

A. That is right.

Q. What about Series A?

A. Series A has some money coming to it from other funds, and their ability to return that money to Series A

would make an appreciable difference in the solvency or insolvency of that fund.

Q. And you refer particularly to the inter-fund loan?

A. That is right.

Q. And particularly the loan of the special income contract?

A. That is right.

Q. That is the oldest, I think, is it not?

A. That is right.

Q. Of the outstanding contracts?

A. Yes.

Q. What about the special annuity contracts.

A. The special annuity contracts, you would run into inter-fund loans again there. Even on the assumption they are worth—that they would be returned in full—the annuity fund based on the figures as submitted in the balance sheet, [fol. 687-695] is insolvent.

Q. By about how much, would you say?

A. I cannot say. There are a good many contingencies depending on the value of certain real estate owned by that fund.

Q. But so far as the special annuity fund, Class A, Class B, Class C, and Class D funds are concerned there is not a great degree of insolvency, is there?

A. No, —well, Series A, there is a contingency there to determine the amount. Series A is not solvent, in my opinion, based on the figures as submitted in the balance sheet. Series B is pretty close to being sound, and Series D is all right. The annuity fund is insolvent.

Q. And the special income fund is, of course, insolvent?

A. Yes.

Q. As I understand, the special income liability was under a million dollars to contractholders?

A. Yes, I think the reserve liability, speaking off-hand—that is in the balance sheet, however—I think it is in the neighborhood of $818,000.

* * * * * * *

[fol. 696] Mr. Fleming:

Q. Would it be possible or practical for each of the states with which securities of Fidelity are now deposited under the various state depository laws, to liquidate those assets

without a great deal of assistance from the home office in the State of West Virginia?

A. Do you mean to liquidate the assets and make the distribution out to the contract owners?

Q. Yes, in each state separately?

[fol. 697] A. I would say as a practical problem it would be most difficult, because the records and the liabilities by contract owners are in the main office, and so far as I know that is the only place whereby the accurate information could be obtained.

Q. From a viewpoint of expense, would it be more expensive or less expensive, in case of liquidation, for liquidation to occur separately in each of the individual states rather than from one central point, and particularly the State of West Virginia?

Mr. Palmer: We object to that question. This Court can not entertain this position and take jurisdiction on any such ground as that. The petition has been filed for reorganization and the petitioner has to carry the burden of showing that there can be a reorganization, and the fact that—if it be a fact—that liquidation might be a little simplified or some less expense by this Court's taking jurisdiction and later ordering a liquidation, certainly would constitute no ground for an order now sustaining the petition as properly filed and holding that the Court has jurisdiction.

The Court: Overruled. (Exception.)

Mr. Fleming: The debtor takes issue, of course, with the position stated by counsel.

[fol. 698] A. Mr. Fleming, I think it would be most difficult for me to state as to the expense of liquidation. I don't believe I could answer with any degree of intelligence as to that at all. As a matter of fact, I never thought about it.

Q. In other words, you cannot state whether or not with, say, 15 state receivers working in separate states endeavoring to liquidate, and the home office here working with them, endeavoring to help each of them liquidate, you cannot say whether that would be more expensive than just one?

A. Oh, it probably would be, but as to saying how much, I don't know the state laws or the amount that the courts might allocate in the way of fees, and so on.

Q. There is an excess of securities in the State of West Virginia, as I understand, amounting to about four or five

million dollars over the liability to contractholders living in the State of West Virginia; is that right?

A. Substantially, yes.

Q. What about the liquidation of that fund covering the rights of the states under their state statutes in that fund? Would it be practical to liquidate, say, in the state court of West Virginia covering all these funds?

[fol. 699] A. I think that is a legal question, Mr. Fleming.

Mr. Farmer: I object as calling for a conclusion of law, your Honor.

Mr. Fleming: I think it might call for a conclusion of fact also, but I don't insist on the question.

The Court: All right.

Mr. Palmer: May I ask if the debtor's purpose in these questions is to show that liquidation would be simpler in your Honor's court than it would in other courts? I have not objected but I would like to know the purpose behind the questions, if I may.

Mr. Fleming: Very frankly, I will say I think it would be much more practical; in the first place, you have the central authority under the jurisdiction of which these various legal questions could all be determined, and in case of liquidation you have a central authority under which that liquidation could be supervised. From a reorganization viewpoint, certainly, I think that reorganization would be practically impossible in the light of these legal problems that exist in this proceeding to reorganize under any other situation.

The Court: It seems to the Court those are very pertinent questions, because of the fact that one of the pro-

[fol. 700-705] visions of the statute with reference to good faith is that it is not filed in good faith if a prior proceeding is pending in any court and it appears that the interest of the creditors and stockholders would best be preserved in such prior proceeding, and it strikes me that is very vital here.

Mr. Fleming: That is a matter this Court must determine from all the facts, evidence and conditions in this case.

Mr. Palmer: I was not objecting. I was just asking the purpose. I think the Court is right.

The Court: Mr. Farmer, however, made the objection and what I said is mainly in reply to his objection.

Mr. Fleming:

Q. You cannot answer the question then, Mr. Smith?

A. I believe I would answer it by saying in my opinion it was a legal question.

Q. Is that your only answer to it?

A. I think that is the only answer I could give,

. . . . . .

[fol. 706] Q. Now, one other thing: Have you in your work for the Trustee, or during your work as a state court receiver, made any investigation as to the advances made to the various sales forces throughout the period of the last five years, or any part of it?

A. I have not gone into that as thoroughly as I contemplate.

Q. Have you gone into it to some extent, enough to give us some idea of that?

A. I know there are on the books outstanding certain advances that have been made to the sales force.

[fols. 707-708] Q. And those advances have been made and have not been repaid, is that right?

A. The balance sheet as of June 6th will show an amount that has been advanced to salesmen, I mean to employees.

Q. Will you give me that amount, roughly?

A. I think the large amount—I am speaking now from the impression I have—that a great portion of these advances to salesmen has been charged off and is not reflected in the balance sheet, of course, of June 6th.

. . . . . .

[fol. 709] By Mr. Lauritzen:

Q. Mr. Smith, a question was asked by Mr. Fleming a moment ago as to whether, if the funds of Fidelity were to be liquidated in the various states where they are deposited, whether it would require a good deal of cooperation on the part of the home office, and I believe your answer was that it would. Now, to break that down a little bit, do you mean that for the states to sell those securities and realize cash on them it would require cooperation of the home office of Fidelity?

A. No, I believe I enlarged my answer, and Mr. Fleming agreed that is what he meant when he said liquidation.

I said did that mean to liquidate the assets and distribute them out, and he said that was what he implied in the question. So just to sell the assets, I think, if it is legal for them to be sold, why, of course, they are in their hands and they are in negotiable form; but to distribute the proceeds, I repeat, would be difficult and might be absolutely impossible without having the records of the home office, Mr. Lauritzen.

[fol. 710] Q. Let me ask you this: If it became necessary to liquidate the various deposits out in the various states, and in the State of West Virginia, to satisfy contract-holders who have a right to have their cash out of those deposits if they want it, and you being one of the West Virginia receivers, if the State of Wisconsin would ask you for certain information or to make available certain records in order that Wisconsin officials might perform their duties in that respect, would you be disposed to assist those officials and make those records available to them?

The Court: Don't answer that question. That is an improper question and I rule it out.

(Exception.)

Mr. Lauritzen: If the Court please, we think this would be quite important as bearing on the issue of whether liquidation in federal court or state court would be more expeditious or efficient.

The Court: Do you mean as to whether Mr. Smith would be willing to give his cooperation?

Mr. Lauritzen: Yes.

The Court: Well, Mr. Smith is just holding that office of receiver by appointment of the court. He may be discharged tomorrow and another receiver appointed, and when you ask Mr. Smith about what his personal attitude [fol. 711] would be toward it you have not helped the Court in any way to know what the real situation is.

Mr. Lauritzen: On the assumption that he would be continued in office.

The Court: Well, no such assumption can be made. That is a question of personality.

Mr. Lauritzen: May I ask it this way: Without respect to yourself individually and personally as a receiver, whether to your knowledge any state court receivers who might be appointed here would not be willing to cooperate

with state officials in Wisconsin or elsewhere to assist them in the performance of their duties, if liquidation in those states became necessary.

Mr. Fleming: The debtor objects.

The Court: Mr. Smith could not possibly know that, and you know he could not know it, so I am going to ask you not to propound any more such questions as that. It simply takes up time and does not do the Court any good. I want such matters brought out as will assist me in determining these questions, but I don't want to sit here and have questions like the last question propounded to any witness. I want the attorneys to govern themselves accordingly, because that is a question that any attorney, I don't care who [fol. 712] he is, ought to know this witness could not answer.

(Exception.)

Mr. Palmer: Your Honor, may I ask it in a different form?

Q. Mr. Smith, while you and Mr. Thomas were state court receivers and other states had receivers in one form or another, was there cooperation between the various states and between you as receivers of the Circuit Court of Kanawha County?

The Court: There is no objection to that question.

A. In what way do you mean, cooperation?

Mr. Palmer:

Q. Cooperation in working at all times towards solving the difficulties in which Fidelity was in; making information available to each other and general cooperation towards the ultimate lines you had in mind?

A. Well, we were friendly between each other. That is, we had two or three conferences with some of the other state court receivers, and we asked them to cooperate with us and they said, of course, they would do all they could. They asked us for lists of contract owners, which we did not feel ought to be sent out at the time and we did not send them out, and some of them got quite "sore" at us, I think, and probably are still, but we did not make those available because we did not feel it was the proper time to [fol. 713] distribute out generally a list of contract owners which was under our supervision and to which we were

responsible to the court of our appointment to protect the interests as far as we could of Fidelity as a whole.

Q. That particular phase of it was so that perhaps those who should not have those lists would not obtain them; is that right?

A. Yes, that would have some bearing on it.

Q. And isn't it true that after the state court receivers were appointed here the other states were notified of that and asked to take appropriate steps to protect the interests of Fidelity in other states—a telegram sent to each?

A. I have seen copies of telegrams the State Auditor sent various states asking for the appointment of—asking that they take the proper steps to protect the assets in this state and the appointment of ancillary receivers.

Q. Isn't it a fact that you and Mr. Thomas, as state court receivers, have cooperated in that information which you felt was proper to be given other states, and have given that information to the proper officials?

A. That is right.

Q. And isn't it a fact that information they felt was [fol. 714] proper and necessary to your receivership they gave to you?

Mr. Fleming: I object as leading and suggestive.

Mr. Palmer: I agree, but I am trying to hurry along, as the Court requested.

A. I don't recall it being necessary for us to ask for any information. There could have been some minor matter, but nothing of importance.

Mr. Palmer: That is all I care to ask, your Honor.

Redirect examination.

By Mr. Fleming:

Q. Is it not a fact that the only cooperation you received, or could have received from these other states, was to permit them to go ahead and sell the securities of Fidelity deposited in those states and distribute the assets to their own contract holders, without regard to the rights of contract holders outside of those respective states?

Mr. Lauritzen: I think you should change the question. He asked if it was the only form of cooperation they could have received, your Honor. If he will ask whether it is

the only form of cooperation they did receive, I will have no objection.

The Court: I understood that to be the question.

A. Do you mean to put it, as a court receiver did I [fol. 715] think that was cooperation by their selling the securities?

Mr. Fleming:

Q. No, I mean that was the only cooperation you received from these other states.

A. Well, I don't classify that as cooperation, if they attempted to liquidate the securities.

Q. I don't either; but can you answer the question?

A. Well, I thought that answered it. I don't construe that as cooperation when they sell the securities they are holding in their states.

Q. Well, that is what Wisconsin did, did it not?

A. In the State of Wisconsin they brought the proceeding to liquidate, which we opposed by counsel, but the order was entered to proceed with liquidating of certain portions of the securities.

Q. Over a million dollars worth of Fidelity securities in Wisconsin were sold; isn't that right?

A. I think they are going to convert—they changed the form of the assets. They changed the form of the assets from bonds over into cash.

Q. From interest-earning securities to cash?

A. That is right.

Q. Any interest being paid on that cash, if you know?

[fol. 716] A. Not to my knowledge.

Q. Were securities sold in any other states?

A. Not to my knowledge.

Q. On Tuesday or Wednesday I requested you, if you could do it, to ascertain the value of the assets of Fidelity situate in the northern district of West Virginia. Were you able to do that, Mr. Smith?

A. Some records are in from Wheeling, or will be in today, which I hope will show that.

Q. They will be available this afternoon, you think?

A. I think so.

Mr. Fleming: That is all, your Honor.

Recross-examination.

By Mr. Lauritzen:

Q. With respect to the Wisconsin proceeding, are you not aware that the statutes under which Wisconsin acted provide for a rehabilitation in the State of Wisconsin, and that was expressly recognized by counsel for the Fidelity and the Attorney General's office in the conduct of those proceedings?

A. The receivers received a letter from the Banking Commission, I believe, of Wisconsin, in which they pointed out [fol. 717] that they were going to get in the claims of the contract holders, and they gave us until, I believe—they said they would withhold any actual distribution until June 30th, gave us until that time to submit a plan or go over a plan with them.

Mr. Reinhardt:

Q. What was the date of that?

A. We were given until June 30th.

Q. When were you given until June 30th?

A. Oh, it had to be, following the chain of events, after the 15th of May; I would say near the 25th of May on which we were given notice that on June 30th the plan was to be submitted.

Mr. Lauritzen:

Q. To recall a little bit further on that, isn't it true that it was agreed between counsel for Fidelity and the Attorney General's office that we would wait until June 30th before we sent out claim forms, because obviously we could not distribute any money before we knew the persons that had it coming to them, and in what amounts?

A. That is right.

Q. That would take a long time, would it not, to ascertain those facts?

A. Yes.

[fol. 718] Q. Now, with respect to the sale of a million and a half dollars worth of securities, are you aware that that was done with the express consent of the then counsel for Fidelity in Wisconsin?

A. I did not receive any notice to that effect.

Q. You have no information on that point?

A. No.

Q. Mr. Smith, are you aware that in the states of Wisconsin and Ohio and in, perhaps, some other states, the Attorney General's office is acting as counsel in the proceedings instituted in those states, without any fee being charged against those liquidations?

A. I know that is true, yes.

Q. Would that have a bearing on your answer to the question Mr. Fleming asked you as to whether you could liquidate more economically here?

A. I don't believe I answered Mr. Fleming direct, and I cannot answer the question direct now.

Mr. Reinhardt: I would like to follow up that line of inquiry, if the Court please.

Q. Are you familiar with the situation in the various states in which there have been receiverships?

A. Familiar in what regard?

[fol. 719] Q. That is, with relation to representation of the receivers and of the state officials interested in this situation by the Attorney Generals' offices in the respective states.

A. Yes, I am familiar with it.

Q. Will you tell us in how many of the states, in which such receiverships were pending, attorneys other than those in the office of the Attorney General of such states were representing the receiver or the state depository, or any other official in such proceeding?

A. The State of Pennsylvania had two sets of receivers; two in the eastern district and two in the western. The question you asked, as I understand you, is this: Do I know the states wherein the state officials did not bring the action and the Attorney General did not represent the state; is that right?

Q. No, wherein the Attorney General of the state did not represent either the state official or the state receiver.

A. They did not in Pennsylvania. I don't believe I could get that without referring to the files, and I am not sure we would be able to determine it from the files.

Q. You don't know as to that situation?

[fol. 720] A. No, I wouldn't be in position to say.

The Court: Would not that appear in some measure from the records we have here of appearances in this particular hearing and otherwise in this suit?

Mr. Reinhardt: It would appear in some measure, your Honor. The reason I asked this question was I understood he had answered Mr. Lauritzen's question on the basis of this type of information. Now, if I am correct in that understanding, then his answer to Mr. Lauritzen's question, on the basis of his present answer should be stricken out.

The Court: About the cooperation and so forth?

Mr. Reinhardt: No, Mr. Lauritzen asked him whether he didn't know that in all these states the receiver and other state officials were represented by the Attorney General of the state.

The Court: He has asked him with respect to Wisconsin only.

The Witness: I did not answer the question with the understanding that it was all of them, but I answered the question in that where the Attorney General did represent the receivers there were no fees paid in such states. I did not mean to answer it that the Attorney General represented them in all states, but just in those states where [fol. 721] the Attorney General did represent them that was the case.

Mr. Reinhardt:

Q. Even in those states where, to your knowledge, if there are such states, the Attorney General was acting in that capacity, do you know whether the Attorney General in such case was acting without compensation other than his official compensation as Attorney General?

A. Oh, I cannot say I actually know, because I don't know the statutes in that state.

Q. Now, with respect to the sales of securities of Fidelity by Wisconsin, Mr. Lauritzen asked whether you knew that was done with the consent of the attorney for Fidelity. I would like to ask you whether that was done also with the consent of the receivers of the State Court of West Virginia.

The Court: He said a while ago it was not. He said they protested.

Mr. Reinhardt:

Q. That is a fact?

A. Yes, we protested to the appointment of a liquidator.

By Mr. Lauritzen:

Q. Just a moment, Mr. Smith, are you aware that Mr. Robert Reeser of Madison, Wisconsin, who has been attorney for Fidelity for some years, was also purporting to act [fol. 722] out there as counsel for the West Virginia receivers in Wisconsin?

A. Yes.

Q. And he was your counsel?

A. Oh, he was acting rather—well, he worked with our counsel, probably at their request.

Q. Well, he was of counsel for the receivers, as well as for the Fidelity as a corporation, was he not?

A. You mean prior to the receivership?

Q. After the West Virginia receivership, did not Mr. Robert Reeser act in Wisconsin as counsel for the West Virginia receivers?

A. I think he worked in conjunction with our counsel.

Q. Such as Mr. Goldsmith of Koontz & Koontz, who came out at one time?

A. Yes, sir.

Q. And are not you aware that Mr. Reeser, as counsel for those receivers, consented to the sale of the securities on deposit in Wisconsin?

A. That could be, but I have nothing in my files and received no such notice of that.

Q. Mr. Reeser did not tell you what he had consented to in that regard; is that right?

[fol. 723] A. It could have been agreed upon by the counsel for the receivers; but I am speaking from my personal knowledge, that I didn't know it was done.

Q. You don't know one way or the other?

A. No, I didn't know it was done.

By Mr. Reinhardt:

Q. Speaking from your own personal knowledge, as to what you did, Mr. Smith, did you authorize or participate in authorizing Mr. Reeser to consent, on behalf of yourself as a co-receiver or on behalf of the other co-receivers, to the sale of these securities in Wisconsin?

A. No, I did not participate in authorizing the consent to that.

Q. In so far as the securities of Fidelity, which were deposited with state depositories, are concerned, was there any discussion as to cooperation between yourself, as one of the receivers in West Virginia, and the receivers appointed in the other jurisdictions for Fidelity?

A. I don't understand.

Q. Well, it is a pretty long question. I want to know whether you talked to any of these other receivers in these other jurisdictions about what you would like them [fol. 724] to do with the securities that had been deposited by Fidelity with the state depositories in that jurisdiction.

A. The receivers I talked to, I told them I hoped they would leave the securities undisturbed until such time as the West Virginia receivers had an opportunity to work out a plan and go over it with them; that we certainly did not want the assets disturbed or sold.

Q. And what was their reaction to that suggestion?

A. The only adverse reaction to that suggestion I can point to was in the State of Wisconsin, where they did proceed to liquidate some of the securities.

The Court:

Q. Did you get any agreements out of any of the other receivers to hold things in status quo?

A. No, your Honor, I have no knowledge of any agreements. I do have knowledge of—I believe Mr. Lloyd of Ohio said they would just stand by. I hope I am not misquoting him; that they would stand by and see what developed over in the West Virginia receivership.

Q. Other than that, was there any one who made any positive commitments.

A. That they would wait?

Q. Yes.

[fol. 725] A. I don't recall that there was.

Mr. Reinhardt:

Q. Did you have contact with receivers or officials in all the states in which Fidelity had deposited securities?

A. No; I may have had correspondence, but no personal contact with all of them.

Q. Without going into too much details, will you indicate to us the states in which you had contact with the re-

ceivers or similar official, and what their attitude was in each case?

A. Well, in Ohio Mr. Lloyd, Ancillary Receiver of Ohio, was receiver for the assets in Ohio other than the state deposits, was my understanding, came over and talked to us.

Q. Let me interrupt you a minute. You referred to Mr. Lloyd as ancillary receiver.

A. Yes, I think the order of his appointment by the Ohio state court made him an ancillary receiver for the assets other than the securities on deposit.

Q. What did those assets amount to?

A. Not very much; some branch office furniture around through the State, small bank balances, not amounting to more than ten or twelve thousand dollars, as a guess.

[fol. 726] Q. How did that compare with the deposited securities, for example?

A. Oh, it is insignificant compared to the deposits, of course. The deposits were around—it is in the record—half a million dollars, as I recall.

Q. What was the situation as to the significant portion of the assets in Ohio, the deposited securities?

A. That is what I say, it was around half a million dollars.

Q. Did you have any discussion which indicated that those would be held in accordance with your wishes, or disposed of in accordange with your wishes?

A. No.

Q. What other states?

A. The receivers for the western district of Pennsylvania came down just to see us. They had no assets. I think the assets had been seived by the receivers in the eastern district, that is, the deposited securities which they had. I think in their district there was some furniture in the branch offices in Pittsburgh, Uniontown and so on; nothing, however, came from that other than they said they wanted to go along and help us, and so on.

Q. They had very little to help you with.

[fol. 727] A. They were going to attempt, I don't know how far they got with it, to get their share of the assets on deposit.

Q. That is from the eastern district?

A. The portion that belonged over in that district.

Q. You mean the receivers in the western district of Pennsylvania were going to try to get from the receivers

in the eastern district of Pennsylvania a part of what the receivers in the eastern district of Pennsylvania had?

A. That is right.

Q. And once they got that, they would be in position to cooperate with you?

A. Yes.

Q. And they expressed a willingness to do that if they got it?

A. They most certainly did.

Q. What else?

A. I don't know—well, we talked with the state officials from Indiana. They came over prior to the appointment of the receiver and I remember asking them particularly if they would not have a receiver appointed over there to protect the assets, and they said they would, and as a [fol. 728] result of the conference over here they went back and the proper steps were taken for the appointment of a receiver.

Q. What else?

A. That is all I recall.

Q. How about Missouri? Did you talk with them or they to you?

A. Yes, they came over here. First, the Attorney General—I believe the Secretary of State has charge of securities in Missouri, and I think the Securities Commissioner—anyway, a receiver was appointed who came over and wanted us to send the securities here on deposit in West Virginia to the State of Missouri. I mean, they are held in the Wheeling bank for the State of Missouri, and they wanted us to agree right off to let him have those securities to ship back to Missouri, and of course nothing came of that. We did not agree.

Q. He was willing to cooperate with you to the extent of having you direct the Wheeling bank transfer the securities from Wheeling to Missouri?

Mr. Schurr: I object to the form of that question as very improper.

Mr. Reinhardt: I will withdraw the question.

[fol. 729] Q. As to these assets in Ohio, which you describe as the insignificant portion, do you know whether they are still in the possession of the Ohio receivers?

A. Yes; such assets as Ohio receivers had were turned over to Mr. Bolden, an employee of the Trustee, just a few days ago.

Q. And are now held by the Trustee as part of this estate?

A. That is right. That is, they turned over the cash they had in their hands, and then the rest of it, certain office furniture, was shipped to Wheeling.

Q. Did you have any contact with the receivers in Illinois?

A. No, I did not.

Mr. Reinhardt: If the Court please, Mr. Huwe has handed me a question. I don't quite get what he has in mind, so I will ask that he be allowed to ask the witness.

The Court: All right.

Mr. Huwe:

Q. Are you aware that, in spite of the cooperation with Mr. Lloyd of Ohio, with reference to leaving out of the receivership proceedings the deposits, that in spite of that fact, a creditor filed an answering cross petition in the re-
[fol. 730] ceivership suit, seeking to bring into that suit the deposits and liquidate them, and that the same creditor laid the foundation by correspondence for a mandamus suit to also liquidate those assets; so, even though Mr. Lloyd cooperated to an extent, he was practically faced with a situation where he could not further cooperate, because of a creditor's activities.

A. No, I don't know a thing about that.

By Mr. Palmer:

Q. Is it not true that after the receivership suit brought in the Circuit Court of Kanawha County, the Auditor of West Virginia notified the various states which were interested in Fidelity and had deposits there, and that they did take proper steps, the officials of those states, to institute court proceedings to carry on or take charge of the matter in their state.

A. As I said, I have knowledge of Mr. Sims' telegram asking for the appointment of receivers to protect the assets in the respective states where they were deposited. A good many states did. I think I am right, in fact I know some states did not appoint receivers, but a good many did.

Q. Were there any states which had deposits in them
[fol. 731] which did not appoint receivers?

A. To my knowledge, I don't believe the State of Maryland did. I could be wrong, just speaking from memory, but I don't believe they did in Alabama, either. They did in most of the states.

By Mr. Farmer:

Q. Mr. Smith, is it not true that to this date not a single state, which was holding deposits for the protection of its contract holders on the day of the filing of this petition, June 6th, has complied with this summary turnover order and delivered the deposits to the Trustee?

A. To my knowledge, the only assets turned over to the Trustee was in compliance of the order of this Court directing the West Virginia receivers to turn over, which we did.

Q. I say, no deposit has been surrendered to the Trustee?

A. To my knowledge, no.

Q. Did you attend this meeting in this court room, an informal meeting on July 9th, which was attended by the Securities Commissioners or the assistant and representatives of the legal departments of some ten or twelve states, discussing this turn-over order?

[fol. 732] A. No, I am sorry I was not here. I wish I had been.

Q. Have you found out this to be true from your knowledge of the business since you have been connected with the Trustee, and the communications you have had, that the invariable uniform attitude of these states is that they will not comply with this turn-over order and they will hold on to these deposits, regardless of what happens in this proceeding; that they will just let the Trustee come out there and see if he can get them on their own home ground?

The Court: What do you mean by that question? Are you trying to convict all these people of contempt of the Federal Court?

Mr. Farmer: I am trying to show that this proceeding—the attempt to reorganize the debtor in this proceeding, a Chapter 10 proceeding, and the summary turnover order that has been made, has created a friction or an uncertainty and disinclination on the part of the state officials having jurisdiction in these various states, to turn over these deposits, and that, without the hearty cooperation of the Se-

curities Commissioners or officials, whatever their titles may be, in these various states in which this company, if [fol. 733] reorganized, would do business, that there is no reasonable prospect of reorganization; and further, that the situation is such that, in view of the doubt of the power and the jurisdiction of this Court by a summary order to compel turn-over of these deposits, that it could only be ascertained at the end of protracted and expensive litigation, whether such power existed or not in this Court, and that in a company of this kind, the success of which is dependent upon the uninterrupted continuity of these payments and the good will of these contract holders, that all of that can be dissipated and lost before any plan of reorganization could be confirmed after all of these legal questions were determined.

The Court: I don't think the question of the Court's power or lack of power to direct the turn-over of those assets has anything to do with the feasibility of the plan.

Mr. Palmer: I think it would be proper to ask, is it not true that the states have resisted the Trustee's collection of them, in a proper legal manner, and have properly and legally raised questions before the Court as to the propriety of the order, indicating that the states are resisting the [fols. 734-735] order through legal processes, rather than agreeing to the plan voluntarily.

The Court: That appears from the pleadings filed. There is no use asking about that.

Mr. Reinhardt:

Q. Mr. Smith, do you know whether the appointment of receivers in states other than West Virginia was made in compliance with the telegram that Mr. Sims sent requesting that such receivers be appointed?

A. I think most of them were.

Q. Do you know? In other words, my question is this: Do you know whether the appointment of those receivers was in compliance by the person who received the telegram with the request contained in the telegram?

A. I think a good many of them were; as to how many, I don't know.

. . . . . .

[fol. 736] Mr. Jaegerman:

Q. Do you know that the Investors Syndicate of America is a face amount certificate company, and has registered

under the Investment Company Act of 1940, and is selling in West Virginia and other states?

Mr. Lauritzen: I object. In the first place, it is apparently a matter of official record with the SEC and could not be the best evidence by quite a far degree.

Mr. Palmer: Let me ask Mr. Jaegerman: Isn't it a fact that they have a new company formed for the purpose of complying with this act, and has most of the structure and body of the old Investors Syndicate Company?

[fols. 737-738] Mr. Jaegerman: I don't see where it is material.

The Court: I don't either. We may form a new company out of Fidelity before we are through with it; and as to Mr. Lauritzen's objection, it is overruled. (Exception.)

Mr. Lauritzen: Further, your Honor, it is a conclusion of law as to whether any company is qualified, because whether you are qualified or not would depend upon an examination of the law, and upon an examination of the papers they filed, and this witness could not possibly answer that.

The Court: Overruled. (Exception.)

Mr. Jaegerman:

Q. Mr. Smith, do you know whether the Investors Syndicate of America is selling fact amount certificates today?

A. I have not had occasion to see one of these certificates being sold. They were sold in 1941.

* * * * * * *

[fol. 739] F. H. Pulfer, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. Give the Court your name, please.

A. F. H. Pulfer.

Q. Where do you live, Mr. Pulfer?

A. 1197 Chatfield Road, Winnetka, Illinois.

Q. Mr. Pulfer, what has been your physical condition, now, for several weeks?

A. Well, I have been quite ill. For the last two and a half years, as a matter of fact, I have been ill.

Q. Has that been a heart difficulty?

A. Yes, sir.

Q. Did there come a time when you entered the employment of Fidelity Investment Association?

A. Yes.

[fol. 740] Q. When was that?

A. I actually entered the employment of the Fidelity actively March 1, 1924.

Q. How long did that employment continue?

A. Until I received a letter from the receivers discontinuing my services.

Q. About when was that?

A. The letter was dated April 25th, effective April 15th, of this year.

Q. 1941?

A. Yes.

Q. In what department of Fidelity were you first employed?

A. As a salesman.

Q. Where?

A. Chicago.

Q. What had been your previous employment, Mr. Pulfer?

A. I had been in the corset manufacturing business.

Q. In Chicago?

A. No, in Kalamazoo, Michigan.

Mr. Palmer: Was Mr. Pulfer employed by National Sales Agency?

[fol. 741] Mr. Fleming: Let me alone, please, until I get the entire complete history of this, and I will appreciate it very much. I don't want to be impatient, but I will get to that directly.

Q. Mr. Pulfer, had you been in the corset manufacturing business very long?

A. Three years.

Q. And what department of that had you particularly to do with?

A. Sales.

Q. What had been your employment prior to that time?

A. I was with the F. E. Compton Company in the book publishing business.

Q. And where were you situated or located?

A. I was located from 1917 until 1922 in Chicago, at

their home office. Prior to that time I was all over the United States for them, selling books.

Q. While you were in the home office of that company, what department were you in?

A. I was vice president of the company, in charge of their recruiting and building up of their sales organization and sales.

Q. The training of their salesmen, you mean?

[fol. 742] A. Training salesmen, yes.

Q. And you were in that employment about how long altogether?

A. Of course, I worked my way through college selling books, so I was in their employ, I would say, from 1911 through 1921, January 1, 1922.

Q. You went through college, I understand, at Indiana University?

A. Yes, Indiana University.

Q. And when did you graduate?

A. 1916.

Q. And then you continued with the Compton Company?

A. Yes.

Q. What was their business generally?

A. Well, they published at that time the New Student Reference Work, but later it became Compton's Picture Encyclopedia, a very fine set of books for children.

Q. After entering the employment of Fidelity in 1924, what was your work at the beginning?

A. I started selling the Special Income Contracts.

Q. In the field?

A. Yes, in the field; on the streets selling it.

Q. How long did you continue that?

[fol. 743] A. Until 1926.

Q. And with what success?

A. Well, with better success financially than I had had in the corset business.

Q. You had not gotten along so well in the corset business?

A. No, the ladies had decided to quit wearing corsets at that time, so business was not so good.

Q. After you quit selling these contracts, as you said, on the streets or from house to house or person to person, what phase of the employment did you enter for Fidelity?

A. Well, I went to Michigan and opened the State of Michigan for Fidelity, and established an office there in

Detroit, and later at Saginaw and Flint and Grand Rapids and other points in the State, and continued my selling and, at the same time, I began hiring and training sales representatives in that territory.

Q. How long did that continue?

A. I was there until June, 1927.

Q. And then where did you go?

A. At the request of the home office, of Fidelity, they asked me to go back to Chicago and take charge of the sales [fols. 744-748] there, which I did.

Q. How long did you remain there?

A. I am still there.

Q. You have been there ever since, working for Fidelity?

A. Yes, sir.

. . . . . .

[fol. 749] Q. Who was the National Sales Agency?

A. The National Sales Agency was Mr. Fred King and Mr. A. L. King, I believe.

Q. Was it a corporation?

A. I believe it was.

Q. And the stock was handled or held by the two Kings, A. L. and Fred?

A. Yes.

Q. What about the other corporation or agency you mentioned?

[fols. 750-751] A. I think it was a partnership.

Q. Did you know those partners?

A. Yes, they were the gentlemen I went to work for originally.

Q. How long did they work for the Fidelity?

A. I don't believe I could tell you when they started, but the partnership, I believe, was dissolved and they both retired from this type of business in 1924.

Q. Then how was their territory handled?

A. No, I will correct that. I believe it was in 1925 that they retired from business. Then the National Sales Agency took over that territory.

Q. How long did National Sales Agency handle sales for Fidelity?

A. I believe it was in 1933 that they ceased to handle any of the sales work for Fidelity.

. . . . . .

[fols. 752-755] Q. After 1933, and after National Sales Agency had ceased handling sales for Fidelity, then what happened to the sales organization of Fidelity?

A. Well, the sales organization then worked for what was termed the agency division of Fidelity Investment Association.

* * * * * * *

[fol. 756] H. Isaiah Smith, was thereupon recalled for further examination, and testified as follows:

By Mr. Jaegerman:

Q. Mr. Smith, when you were last on the stand you were requested to furnish this Court with a break-down of the cash surrender liability and other contract liabilities by funds and by series, and further broken down by geographical distribution; in other words, by states. Do you have [fol. 757] that information available now?

A. Yes, I have secured it.

Q. I show you a chart, entitled "Fidelity Assurance Association Geographical Distribution of Number and Face Amounts Required Reserve Cash Liability and Contracts Loans on Contracts in Force April 10, 1941" and ask you to identify it.

A. That is correct.

Q. Does this chart show the liability in every state in which contract holders reside, regardless of whether or not the contracts were sold in those states?

A. That is right.

Mr. Jaegerman: Your Honor, we offer this chart in evidence as Exhibit No. 34.

The Court: It may be received.

Exhibit No. 34 Filed

Mr. Lauritzen: Did you have him identify it further as to who compiled it and the source of it, and his connection with it? I did not understand that that has been done.

Mr. Jaegerman:

Q. Mr. Smith, was this exhibit prepared after you became a State Court receiver?

A. Yes.

[fol. 758] Q. Was it prepared at your direction?

A. It was; that is, the joint direction of the two receivers.

Q. You and Mr. Thomas?

A. That is right.

Q. It was prepared by the staff of Fidelity Assurance Association?

A. That is right.

Q. From the books and records of Fidelity?

A. That is right.

Q. After this was compiled by the staff, was it submitted to you in your official capacity as co-receiver?

A. It was.

Q. This Exhibit 34 shows not only the number of contracts outstanding in each state, but the face amounts of those contracts?

A. That is right.

Q. Required reserves?

A. That is right.

Q. The gross cash liability?

A. Right.

Q. The contract loans and accrued interest?

A. Right.

[fol. 759] Q. And the net cash liability?

A. Right.

Q. This shows the Income contract fund, the Annuity Contract fund, the Series A Contract fund, the Series B Contract fund, the Series C contract fund, and the Series D Contract fund?

A. Right.

Q. Each separately?

A. That is right.

Q. Then there is a total column?

A. A general summary.

Q. Being the number of contracts and the face amount?

A. Right.

Q. Is not this fund divided by the active contract fund and the maturity and retirement reserve fund, where such separate funds are maintained for any one series?

A. It is.

Mr. Farmer: May we see that? I don't know whether we will object to it or not.

Mr. Jaegerman: Certainly (handing exhibit to counsel). Is there any objection on the part of any attorney to this exhibit?

Mr. Farmer: No, sir, it appears to be what we have been [fol. 760] calling for for about three days.

Mr. Jaegerman: I am sorry Mr. Huwe is not here. He has just stepped out, I suppose. He is the man who made the request this morning for this exhibit.

Your Honor, I have no further questions on this exhibit.

The Court: Is there any cross-examination with reference to the exhibit?

Mr. Farmer: Your Honor, we may want to ask some questions later. This is quite a voluminous calculation, and it is impossible in a few minutes to examine it and say. I don't think so, but it is hard to say right now whether we will want to ask any questions about it or not.

The Court: All right. Is there anything further with this witness?

Mr. Reinhardt: Yes, your Honor, I would like to ask a few questions.

By Mr. Reinhardt:

Q. Mr. Smith, you are familiar with the assets of this debtor as of June 6, 1941, are you not?

A. Familiar with the record of the assets, yes.

Q. Now, will you tell us the following facts about those assets: the nature of them and as to each asset, whether [fol. 761] it was located in Charleston on June 6, 1941, whether it was located in Wisconsin, Illinois, or any other place outside of Charleston on June 6, 1941, and the market value on June 6, 1941?

The Court: Why not also include in that whether located in any other place in West Virginia besides the southern district?

Mr. Reinhardt: That would be included, your Honor, among all others.

The Court: I would like to find out where all the assets were. You said in Charleston or other states.

Mr. Reinhardt: This will cover all the assets. What I have asked for is that all the assets be broken down into the following groups: those in Charleston or within the jurisdiction of the southern district of West Virginia, and the assets which are located anywhere else than in this jurisdiction. I understand that the witness has broken that second group down into Wisconsin, Illinois and any other place simply because those two jurisdictions mentioned happen to have the largest single aggregation of assets of this debtor as of that time.

The Court: All right; go ahead, Mr. Smith.

A. The assets as of June 6, 1941, as shown by the records [fol. 762] of the company, are comprised of securities—I will not attempt to classify those, that is, stocks, bonds and so forth, real estate and mortgages on real estate, and cash, and loans to contract holders; that is, loans secured by the contract owner's contract itself. Then furniture and fixtures and an equity in a life insurance policy carried on a former employee, a former person who performed services for the company, and loans to Fidel bond holders, and accrued interest on bonds and mortgages and so forth; then, of course, you have that little odds and ends of small items that we usually classify for bookkeeping purposes under "Miscellaneous Assets".

The market value of the securities as of June 6, 1941, located in Charleston, that is, on deposit with the State of West Virginia, amounted to $9,592,128.83; mortgages, the book value of those mortgages, and that consisted of the home office—for instance, in this total assets, in the balance sheet, the home office is carried, that is, the deed to the property or title for the property being vested in the association and carried at a book value; then, in turn, a mortgage was placed on the home office which is owned by the two contract [fol. 763] funds, or two of the reserve funds, so if you total up the total assets, as shown by the balance sheet, you would be carrying the same piece of property twice as an asset; so that was, of course, something that could not exist, that is, you could not count the home office building as an asset in the general fund and then count the mortgage on it up to the full amount of its book value as an asset in another fund. The book value of the assets, therefore, the mortgages on deposit with the State of West Virginia, have a

book value of $1,082,567.25. There was cash which had been transferred by the receivers to the banks in the City of Charleston on May 23rd, $250,000; and then cash, in the amount of $111,019.05, transferred to the banks in the City of Charleston, which were funds segregated under the order of the Court; the accrued interest on bonds and the accrued interest on mortgages, on the securities and mortgages on deposit with the State of West Virginia in Charleston amounted to $171,504.58, making a total of $11,207,219.71.

On June 6, 1941, as shown by the records in the office in Wheeling, the market value of securities on deposit in the State of Wisconsin was $2,619,399.07; the accrued interest on these securities amounted to $17,150.46, making a total [fol. 764] asset as shown by the records in the office of $2,636.549.53 in the State of Wisconsin.

On June 6, 1941, in the State of Illinois, the market value of securities on deposit, as shown by the records in the office, was $3,759,894.00; and the accrued interest on these securities, as shown by the books, was $42,876.14, making a total of $3,802,770.14.

All other assets, located as shown by the records in the office, the market value of securities was $3,350,482.69; the real estate book value was $438,105.11; mortgages, book value, $208,675.94; cash on hand and in bank, $347,324.08; cash deposited under the order of the Court by the receivers, to be held at the direction of the Court, was $169,597.65. Loans on contracts, secured by the——

Mr. Reinhardt:

Q. Just a minute. Let me ask you this: contract loans have no physical location, is that right?

A. That is to be determined by this explanation, that these contract owners probably scattered all over the country would borrow money on their contracts and execute a loan agreement, which is carried as an asset on the company's books. As to where it might be located, the physical contract and the contract agreement by the contract owner [fol. 765] of course, is located in the home office. That figure is $1,459,271.07.

The book value of furniture and fixtures is $79,694.74. The life insurance policy, the cash surrender value less a loan, the net equity in the value of this insurance policy is $2,994.24. The loan to Fidel bondholders, $156,406.52, and

accrued interest on bonds, mortgages, and so forth, $111,477.99; miscellaneous assets, $21,483.75, making a total of assets located in other than the three categories named heretofore, $6,345,513.78, making a grand total of assets, as shown by this report, $23,992,053.16.

Q. Now, of these assets, contract loans of $1,459,271.07, life insurance policy of $2,994.24 and loan to Fidel bond holders $156,406.52 are the type of thing that has no physical location; is that right? I mean, there is nothing you could point to that is that thing, or any of those things?

A. No, it is really—well, the loans for instance, to contract holders is really a method of bookkeeping, but it is a lien on the contract holder's cash value on his contract.

The Court: In effect, it simply reduces the liability, rather than builds up the assets?

[fol. 766] A. That is right.

Q. But as it is handled the liability is left on the books and the asset is placed to offset it.

A. That is right.

Mr. Reinhardt:

Q. When a loan is made to a contract holder, does he sign a note for that loan?

A. He signs a loan agreement, which is the same thing as a note, I would say.

Q. Where were those loan agreements located on June 6, 1941?

A. In the home office.

Q. In Wheeling?

A. That is right.

Q. Is the same thing true as to loans to Fidel bondholders?

A. No; I hope I won't make it complicated, but under the indenture of Fidel, a wholly owned subsidiary of Fidelity, the Fidel bond, itself, did not agree to loan the bondholder any money at all on its contract, but in the indenture the parent company of Fidel, or Fidelity, agreed to make these loans. The mechanics, briefly, are these: the bondholder would send his bond, with a loan agreement, to Fidelity. Fidelity would make the loan. Fidelity would, [fol. 767] in turn, execute its note and secure that note with the contract owner's loan agreement and his contract, and

forward it to the Trustee for Fidel, who in turn would buy that, one of the reserve funds, and Fidelity would get the money back.

Q. The Trustee for Fidel, to whom this stuff was sent by Fidelity, was located where on June 6, 1941?

A. The Colonial Trust Company, New York City.

Q. Is that where these documents were at that time?

A. That is right.

Q. On June 6, 1941?

A. That is right.

The Court: Let me ask this question: I did not notice whether Mr. Smith gave a total of the market value of assets situated out of the southern district of West Virginia, or not. He gave the total of $11,207,000 assets situated in this district, but not the total outside.

Mr. Reinhardt: I don't believe he did, your Honor. In doing that, may I suggest that Mr. Smith eliminate contract loans, life insurance and loans to Fidel bondholders, because there may be some question as to where those were located, because of their nature.

[fols. 768-772] The Court: They can be tabulated separately. Yes. Also, you gave the answer in two separate items; one, the total of the items just mentioned by Mr. Reinhardt, and the other, all other assets.

A. The assets, according to this schedule on June 6, 1941, in Charleston, amounted to $11,207,219.71; assets located outside of the City of Charleston, $12,784,833.45.

Q. Including contracts and so forth, or excluding?

A. Including. Now, if we exclude the loans to contract holders, the value of the life insurance policy and the loan to Fidel bond-holders—I repeat, by excluding contract loans, cash surrender value of the life insurance, loans to Fidel bond-holders, the assets located in places other than Charleston would be $11,166,161.62.

Mr. Reinhardt:

Q. What is the total of those three items you have excluded?

A. $1,618,671.83.

Mr. Reinhardt: That is all, your Honor.

* * * * * * *

[fol. 773] Q. In the course of your business career, have [fols. 774-778] you ever occupied a position which called upon you to form opinions as to the value of real estate?

A. Yes, when I was a Bank Commissioner I would have to pass on values of real estate.

Q. I thought you testified you were a State Budget Director once?

A. That is right.

* * * * * * *

F. H. Pulfer—Direct.

[fol. 779] Q. Tell the Court, if you will, what occurred at that meeting.

A. Every director was present except Mr. Burt, and Mr. Risley, and the only thing that Mr. McNulty was there for—he was not a director, but he was secretary of the company, and there was some discussion about his possibly being embarrassed by being present there, since he was working for the receivers, and he thought that he would be if he attended the meeting, so he resigned as secretary and left the meeting. Mr. King was elected secretary, to take the minutes of the meeting.

The discussion was largely a matter of what was the best thing to do under the circumstances. The feeling was that it would be best to bring this matter into a Federal [fols. 780-783] Court. The resolution was passed to that effect.

Q. What about the situation of the company at that time as to being in receivership and state receivers being appointed and so forth?

A. Well, of course, in the matter of reorganization we all seemed to think that it would be very difficult to attempt to do that with so many receivers in so many states, and that until this was brought into one jurisdiction, where you could deal with one court, why, you would be up against a very difficult job in even attempting to effect any reorganization plan.

* * * * * * *

[fol. 784] Q. Explain, if you will, briefly the character of people who bought these contracts in your territory, and whether or not the rate of interest was a controlling factor;

just explain generally your methods and the policy of selling these contracts.

A. Well, of my own personal opinion, I don't think that the rate of interest ever had much to do with the sale of a Fidelity contract.

Q. Explain that to the Court, please.

A. I don't think people bought these contracts because they were going to receive any special rate of interest. We sold these contracts based on its being a compulsory savings plan; in other words, to get a man to do something he otherwise would not do. I had not been in this business but thirty days until I learned that was the principal appeal, that this particular thing carried. In other words, and for example, the matter of saving money is a difficult thing for the average person to do, and most of them will not do it [fol. 785] unless they are urged or impelled to do it some way or other. Now, this plan offered that urge; it offered that element of compulsion which would get a man to do that particular thing, which otherwise he probably would not do, and I don't believe that the terms of the contract, in so far as interest was concerned, had very much to do with it. Certainly we did not sell it based on that.

Q. Now, to what class of persons did you sell contracts?

A. Well, of course we sold contracts to pretty near all classes of people.

Q. Explain that briefly.

A. We have some of the outstanding business men, bankers, professional men of the different communities who use these plans for savings, and have done so far years. I can name many of them: William Wrigley, Warren Wright—and I might say, when he concluded his plan with us, he wrote us a letter and said he had never missed the money that he had saved; that it was like walking out in the street and finding it.

Q. Who is Warren Wright?

A. At that time he was president of Calumet Baking [fol. 786] Company. He was better known later because he owns Whirlaway, the horse of the year.

However, we have sold many men of that type; bankers of Chicago and Detroit, who have admitted to me that they had better success in saving money under this plan, than in their own banks, because they would not do it in their own banks.

Q. What about the future of Fidelity in so far as the continued use of this plan is concerned, Mr. Pulfer?

A. Well, of course, I think there is just as big, if not bigger, fields today than ever.

Q. For compulsory savings?

A. Yes, sir.

Q. Irrespective of the rate of interest?

A. Yes, sir.

Q. Except that the company cannot agree to pay a larger rate of interest than they can afford to pay under present conditions.

A. Yes, but I don't think that makes any difference in selling.

Q. Have you heard of the Investors Syndicate?

A. Yes, sir.

Q. What business are they engaged in?

[fol. 787] A. Very similar or practically the same, except as to the terms of the contract, and other details.

Q. Are they still engaged in business?

A. I understand they are.

Q. And successfully?

A. I understand they had a very nice business last year.

Q. And had a large appreciation in assets?

A. I was told in Chicago they had an increase——

Mr. Palmer: I object to what he was told in Chicago about their business. I am afraid that would be heresay.

Mr. Farmer: I object to counsel leading the witness also.

The Court: I am going to let him testify as to that. Overruled. (Exception.)

A. I will amend it by saying I was told by a member of their organization that the increase in assets was over ten million dollars.

Mr. Palmer: I object, and move to strike that out.

The Court: Overruled. (Exception.)

Mr. Fleming:

Q. Do you know how widespread their activities are?

A. No, I don't believe I can answer that.

[fol. 788] Q. Do you know the aggregate, or approximately the aggregate amount of their assets today; that is, the Investors Syndicate?

A. No, I don't believe I can answer that.

Q. In your opinion, do you think it is feasible to develop a plan of reorganization in this proceeding and rehabilitate the affairs of Fidelity?

A. I think so.

Q. Explain that, if you will.

A. Well, of course, after spending over seventeen years in this business, and after seeing the results that this plan has given to many hundreds and thousands of people, I think it performed a great service and, with the number of people that are using the plan, with the soundness of the plan properly revised to meet present day conditions, I think it would have just as as great an appeal today, or greater, than it had in the past, because many things have happened in this country in the last few years that, in my opinion, make people more savings-minded than ever before. There is an editorial in the local paper, I believe, this morning as to Secretary Morgenthau making a statement with reference to compulsory savings. The activities of the Government in assisting people to save are many, and is [fols. 789-793] proving a helpful thing. All those things contribute, in my opinion, and did contribute to making the plan successful and making this business more successful and better than ever. I don't regard those as competition.

Q. In other words, a well managed company, pursuing, or at least partially pursuing the savings plan followed by Fidelity could succeed financially, in your opinion?

A. I think so if properly handled, and they don't promise too much.

* * * * * * *

[fol. 794] Q. Was there some sort of merger or refinancing plan that Mr. Messick and Mr. Rosset had been interested in developing for the company prior to that time?

A. Well, I brought Mr. Messick into the picture; perhaps I had better explain that.

Q. I wish you would.

A. There had been a great deal of talk about the need of additional capital for the company. One of the officers and directors of the company had taken it upon himself to raise capital for the company. He had been unsuccessful in doing so. I told them then, in Wheeling, that I thought some people in Chicago might be interested in coming into this Fidelity picture, and perhaps provide whatever capital was necessary.

One year after I told them that, they told me I might proceed to talk to those people. I saw that the need was for more than capital, and I felt the need was for management as well as capital.

Now, I had known Mr. Messick thirty years, at Indiana [fol. 795] University together, and so they were having a little group of Indiana University men at luncheon for Paul McNutt in Chicago, and Mr. Messick happened to be sitting at my table, and I talked to him about Fidelity. The next day he came to my office and I told him more about it. He had been very successful in his business career, had been a banker and a lawyer, and had had considerable experience in reorganizing matters, and I told him I wanted his help. He became interested in the picture.

It was through Mr. Messick that Mr. Rosset became interested. After they had studied the preliminary figures on Fidelity, and had gone over the many different factors entering into this Fidelity business, why, they jointly decided they, perhaps, could do something about it, and they presented a proposition to the company, to the board of directors of Fidelity, which the board passed on and which gave them the option or the opportunity to look further into the affairs of Fidelity, with a view to contributing capital and management. That was never consummated because the company could not qualify under the terms of the agreement.

Q. Explain that, if you will.

[fol. 796] A. There were several things about that, that did not seem to work out. One was the deposit of the common and preferred stock with the Trustee in a given percentage. Another was that it was predicated upon the examination of the portfolio, and the assets of the company. That did not work out just as well as they thought it should. Then, I think the thing that caused the collapse of that program of Rosset and Messick was when Mr. Messick found the source from which money was coming.

Q. Through Mr. Rosset?

A. Through Mr. Rosset; it was coming from a man named Green in Chicago, who did not bear a very good reputation, and as soon as he told me about it, I said, "We don't want anybody like that in Fidelity," and our judgment was pretty well vindicated, because Mr. Green was later indicted for some kind of stock shuffling in connection with Esquire Publishing Company.

Q. That appeared in all the newspapers, I believe?

A. That is right. The minute his name was mentioned, I know that I felt we did not want anybody like that mixed up in that business, and the board of directors knew of that situation.

Q. The board of directors knew all about these circum- [fol. 797] stances and everything connected with this deal, and why the deal was not developed beyond the point where it was; is that right?

A. That is right.

Q. And knowing all that later Mr. Messick was elected chairman of the board of directors; is that right?

A. That is right.

Q. When was that?

A. I cannot tell you the date; I don't remember.

Q. Was that in August?

A. I think it was at a board meeting held in August.

Q. Was he present?

A. No.

Q. Were you present?

A. I was there.

Q. Who else was there?

A. I believe we had a full board meeting, the minutes would show.

Q. Was Mr. Marshall there?

A. I believe he was there; I don't remember. The minutes of the corporation will show who were present; I don't recall.

Q. Was a salary fixed for Mr. Messick; or do you recall [fols. 798-803] that?

A. It was fixed at $1,000 a month.

Q. And that was last August, 1940?

A. Yes.

Q. Did Mr. Messick accept his election as chairman of the board of directors of Fidelity?

A. He wrote a letter accepting it, and stating in the letter the terms under which he would accept it.

Q. Then if he became rather active in the management at that time, you may tell the Court about it.

A. Yes, he did.

Q. And where did he have his principal office?

A. In Chicago.

Q. His principal office was in Chicago?

A. Yes.

Q. I will ask you whether he gave practically all his time to Fidelity.

A. He gave all his time to Fidelity.

Mr. Palmer: I object, unless the witness was there personally.

Mr. Fleming:

Q. Were you there personally?

A. I know that he gave all his time to the affairs of the company before and after his election.

. . . . . .

[fol. 804] Mr. Fleming:

Q. Mr. Pulfer, do you think of anything else you would like to explain to the Court?

A. You asked whether the company should go on, or whether this type of business should go on. Of course you know some of the men who have been out in the field end of the Fidelity business have had a great many experiences that, perhaps, have never come to some of you gentlemen in the room here, in dealing with people who have matured their contracts, or people who have come into the offices under great stress, under great urgency, to cash surrender their contracts, or want to borrow money on them and get the maximum loan value.

After all, the reaction of people who have used the plan for a number of years gives you a pretty good measure of its worth and you have learned, from talking to these contract holders and hearing them express themselves, what they think about it, as being so thoroughly satisfied with the services of the company, that they are thoroughly [fol 805] sold on the idea.

Having seen a good many young men go off to college, who otherwise would never have gotten there; I think, if I may just use an illustration of one case, that it will show you what I mean. There was an old janitor for a large apartment house in Chicago, who came in the office and received his commuted value on a contract and shortly thereafter used the proceeds to take his wife and two children and a little old Ford car over to his native country of Rumania, where he spent some sixty days, traveling through that country of his boyhood, and he sent me postcards from all

over that area, "Having swell time. Would not be here if it was not for Fidelity," and things like that—they just occur all the time.

Mr. Farmer: I object to that line of testimony because it sheds no light on this question.

The Court: I don't see how that helps the Court, so we will not go any further along that line.

Mr. Fleming:

Q. The articles of incorporation of Fidelity were amended near the close of the year 1940, under the laws of the State of West Virginia. Are you acquainted with the reason or reasons for that, or do you know how that happened to be done?

[fol. 806] A. I think it was the concensus of opinion that we probably would have broadened our field of selling to include insurance.

Q. Along with the sale of——

A. Along with the sale of the type of plan we had been selling. Now, during this period from December 14, 1938, on, many of our sales representatives had found it necessary to supplement their work with Fidelity by doing some work with insurance companies, and the two are really closer together than you think, and in many cases where our sales representative would develop a client, why, he very often would be asked whether he could furnish insurance; so that I think it was just—well, the thought was that it would broaden our field to include that along with the type of business we have been doing.

Q. Was it your intention to abandon completely the business of selling annuities?

A. No, sir.

Q. Had you ever sold anything else?

A. No, sir.

Q. Did you ever sell any or issue any insurance policies?

A. No, sir.

[fol. 807] Q. You never operated under the additional powers granted by the amendment to this charter?

A. No, sir, we were never permitted to sell.

Mr. Fleming: That is all, your Honor.

The Court: Any cross-examination?

Mr. Palmer: Yes, your Honor.

Cross-examination.

By Mr. Palmer:

Q. Mr. Pulfer, what office did you hold with the company at the time of the suit in Detroit in 1938?

A. I was the Supervisor for the States of Illinois and Indiana.

Q. Now, at this meeting in Pittsburgh, Mr. Pulfer, was Mr. D. A. Burt a director, and was Mr. C. E. Smith also a director?

A. Both D. A. Burt—no, D. A. Burt was a director then.

Q. How about C. E. Smith?

A. No, he was not a director.

Q. After the Pittsburgh meeting you said it was the feeling there that the case should be brought into a court that had jurisdiction over all the states.

A. No, that was not what I said.

[fol. 808] Q. I am sorry; what was it?

A. I said I thought if the jurisdiction was within one court, that it would be easier to effect a reorganization than if it were necessary to deal with several courts.

Q. And you felt at that time, did you not, that all of the various assets should be gathered under one authority, under that one court?

A. No, not necessarily.

Q. That was not part of the feeling of the group?

A. No.

Q. Did you apply for, or were you granted any exemptions by the Securities and Exchange Commission to act as director or officer of the company after the suit in Detroit, and after the enactment of the Investment Company Act of 1940?

A. I don't recall that I did. I was not a director at that time.

Q. Your best recollection is, you were not granted any immunity; is that correct?

A. I don't recall that, or applying for any.

Q. Now, with reference to the money advanced you and other salesmen—I am not inquiring as to you individually, [fol. 809] Mr. Pulfer,—it is my understanding that during this suit in Detroit the company advanced moneys to you and other salesmen for your living expenses, or advanced the money for whatever purpose you cared to use it; is that correct?

A. Well, they sent money to us; whether they advanced it or not, I don't know.

Q. Did you say some of that had been written off the company's books as a loss?

A. My understanding is that has been done.

Q. Did you ever tell any of the prospective customers that advances or money was given to salesmen for work not done and commissions not earned?

A. No, sir.

Q. Did you know that in 1934, Edgar B. Sims, Auditor of the State of West Virginia, on October 12th of that year, wrote to the officers and directors of the Fidelity Investment Company at Wheeling, as follows:

"DEAR SIRS:

"I have had a conference with Mr. Weiss and Mr. A. L. King. Also on yesterday I had a conference with President Howard Sutherland of your institution. I find that these gentlemen still think it is all right to pay salesmen moneys in excess of the commissions on moneys actually collected and turned in to the company. And Mr. Sutherland [fol. 810] argues that there was no wrong perpetrated in the payments permitted by him of sums in excess of the commissions on moneys actually collected and turned in by the National Sales Company, and admits that there is a $66,000 increase in the advances to the Sales Agency. However, we find that there is an actual increase of $88,000 since the audit of January 1, 1933. Further, Mr. Sutherland argues that this is not stealing, and claims that it is only a matter of judgment.

"This office is unalterably opposed to his action and his contention. We hold that the taking of money from any source and paying it out before it is actually earned and collected constitutes the misuse of trust funds and is in plain terms 'embezzlement' or 'stealing' and would not bear the scrutiny of a Grand Jury.

"Therefore, we fell that the Board of Directors should take immediate steps to place somebody in charge of this institution who knows what stealing is when he sees it and is opposed to it.

"Yours truly, Edgar B. Sims, State Auditor and Insurance Commissioner."

Mr. Fleming: Your Honor, I object to that. This witness is not a director, or was not at that time, and I don't think this would throw any light on the issues involved here. I have no objection to the witness answering the question, but I feel that this line of cross-examination is outside of the issues in this case.

. . . . . .

[fol. 811] Mr. Palmer:

Q. Did you know that on September 19, 1934, Edgar B. Sims, wrote the following:

[fols. 812-815] "Charleston, W. Va., September 19, 1934.

"Private Rulings to the Officers of the Fidelity Investment Association, Wheeling, West Virginia

"1. No sums of money shall be advanced to any salesman, agent, agency or sales manager in excess of commissions actually earned and collected.

"2. If any salesman, agent or agency now owe the Association for advances made in excess of commissions earned and collected, a part of commissions as collected on any business must be applied on the debt owing from said salesman, agent or agency.

"3. If any salesman, agent or agency of the Association have advances against deferred commissions, such deferred commissions shall be applied when and if collected to the said advances against such deferred commissions.

"4. Any officer or employee of the Fidelity Investment Association knowingly violating these rules will be held to account according to law.

"Edgar B. Sims, Auditor and Ex Officio Insurance Commissioner."

Now, did you know that Mr. Sims had written that to the officers of Fidelity, Mr. Pulfer?

A. I have no way of knowing that. I was not an officer or director.

. . . . . .

[fol. 816] Q. You did not permit them earlier than two or three years ago to sell insurance as a side line, did you?

A. We never permitted them.

Q. I thought you told us about your salesmen selling insurance?

A. I did, but I did not say we permitted it.

Q. Well, you knew about it?

A. We discovered that.

Q. But did nothing about it?

A. We discovered it subsequently.

Q. You discovered it subsequently?

A. Yes, after some of these men had left us and had turned in their sales kits, and we found what was there. [fol. 817] We didn't know it at the time they were working.

Q. Now, you say there is a great appeal today to persons to save on the installment plan; is that right?

A. Yes.

Q. Do those persons demand to know or to look at the facts as to whether they will get their money back, after they save it?

A. I would think so.

Q. Did you know that 5.29% of the persons who invested in Fidelity, as discovered by the Securities and Exchange Commission, over a ten-year period, were all that received their money back at maturity?

A. No, I didn't know that.

Q. Would that have been something those people would have been interested in knowing?

A. Well, they might have been more interested in the company record—the complete record of the company in a ten-year period.

The Court: I want to find out something about that. I notice that question has been asked a number of times. I would like to know from this witness, or from some other witness, the cause for that small percentage who received their money back eventually. Was it because they paid in [fol. 818] a while and dropped it, or just that there had not been time yet for the contracts to mature, or that they had switched contracts and taken extensions in some other form, or something of that sort? What is the explanation of that small percentages of maturities?

Mr. Palmer: I think the Court is perfectly right. My figures are based on figures procured by the SEC by investigation of their statistics over a long period, and——

The Court: Well, do you, yourself, have any such information as that I have just asked for?

Mr. Palmer: Yes, sir; I have a copy of the hearing and the testimony of Mr. Fred Risley before the SEC in January, 1938.

The Court: Is he going to be a witness?

Mr. Palmer: I presume so; he is the president of the company; I suppose the debtor will certainly put him on the stand. I should think he would be one of the most important witnesses.

Mr. Fleming: No, he is not here, your Honor. If you want him I will be glad to have him subpoenaed, if I know where he is. I am not sure that I know where he is.

Mr. Palmer: I would think we would certainly want [fols. 819-830] to cross-examine him, under a motion of cross-examining the officers, before the trial, as being the most important officer of the company, the president, and the actual managing head. I had no thought but what he would be here, your Honor.

The Court: If he cannot be obtained today or tomorrow, we might as well wait until later to rule on that.

Mr. Fleming: I will be glad to endeavor to have him come in, if you want him.

Mr. Palmer: I would like very much to examine him.

* * * * * * *

[fols. 831-835] Q. Have you made any attempt to pay back the advances made to you, or have you repaid any part of the advances made to you?

A. I don't consider them as advances.

Q. My question is, have you repaid any of the money advanced to you?

A. No.

Q. They are still on the books of the company, of which you were a director, as a charge against you; isn't that right?

A. That is what you say.

Q. That is what I am asking you.

A. No, you are telling me that.

The Court: Answer the question, Mr. Pulfer. I want to get this examination through, and I don't want the wit-

ness to begin arguing with the attorney. Just answer the question.

A. Well, apparently they were.

. . . . . .

[fol. 836] Q. Mr. Pulfer, you are familiar with the fact that the company made deposits in the various states in accordance with the state laws; are you not?

A. Yes.

Q. Can you tell us what representations were made to prospective purchasers with respect to such deposits securing their contracts after they purchased them?

Mr. Fleming: The debtor objects as immaterial to the issue being presented at this time.

The Court: I cannot see that it is quite material to these issues, myself, Mr. Lauritzen. Will you explain why you think it is?

Mr. Lauritzen: Yes, sir. The sales literature and the sales presentation of the company, according to our information, laid the most heavy stress on state deposits, both with respect to the deposits made with the State of West Virginia, and the deposits made with every other state, and the law of West Virginia was quoted in that sales presentation, and the laws of the other states were quoted in that sales presentation. It was a trust fund on deposit with [fol. 837] those states, and according to our information——

The Court: You mean the literature said it was a trust fund?

Mr. Lauritzen: The literature and the instructions to salesmen, and the actual presentation by salesmen, and I think this witness can tell us of that phase of the sales presentation better than the literature—the actual selling conversations with the prospects.

The Court: How is that going to help the Court in determining the question we have at issue now, as to whether or not the Court has jurisdiction in this case, and whether or not the provisions of the statute have been complied with, and the petition filed in good faith?

Mr. Lauritzen: Just this, your Honor, if I may refer to one document here to illustrate my point. Here is a part of a presentation, referring to securities in the company's portfolio, and the last thing that is done with those securities, according to this presentation, is this, and I quote:

"Deposited with state departments for the exclusive protection of all contract holders."

Now, if those deposits are a trust fund, and if——

The Court: There is nothing said there about a trust [fol. 838] fund.

Mr. Lauritzen: Oh, but there is in the other part, your Honor.

The Court: All right; go on.

Mr. Lauritzen: I did not read it all. It is fully stated there, and I believe Mr. Palmer will bear me out that the sales presentation shows that there were trust funds on deposit to secure the cash surrender value; that when you came to get your cash from the company, at such time when you wanted it, in accordance with the table of cash surrender values, if, for any reason the company was not able to produce it, then these state deposits secured that to you, beyond any question of a doubt. Now, if that is what was done, and the contract was entered into between these purchasers and Fidelity, then those contract holders are entitled to have that cash in so far as the executed portion of their contract is concerned, and it is our position, as maintained in our answers, that no proceeding, reorganization, or otherwise, could abrogate that right to have that cash at such time as they wanted it, not on an extended basis, not on a modified basis, but exactly in accordance with the representations made to those contract holders. To us that is [fols. 839-843] a crucial point in this case, your Honor.

The Court: Let me see if I understand you, Mr. Lauritzen: Your contention is, that in view of the fact that the statutes of Wisconsin, we will say, provide for a 110% deposit, and then in selling in Wisconsin the salesmen told the purchasers of the provisions of the statute, and then the purchasers bought and paid in money on the contracts, that, then, in this proceeding, regardless of how much the company actually has to comply with what it said it was going to do, that all of those persons who purchased are entitled to be paid in full.

Mr. Lauritzen: In cash; yes, sir.

The Court: All right.

. . . . . .

[fol. 844] The Court: I cannot see how there could be any [fols. 845-857] doubt or objection to agreeing—of course, I

am not speaking for any of the attorneys—but that contracts were sold with the representation made that they were sold under the laws of the particular state in which they were sold, and that those laws would be complied with. Does anybody object to any such stipulation?

* * * * * * *

[fol. 858] Q. Can you give me the approximate number of shares of stock you owned in the company?

A. Oh, I imagine probably, in my name, ten shares of common, and fifteen shares of preferred.

Q. Now, is it not a fact that, from your knowledge of the affairs of the company at the time of that meeting in Pittsburgh, you knew there was no hope of you, as a stockholder, realizing anything on your stock by virtue of any plan of reorganization?

A. I have not been interested in the picture, from the standpoint of a stockholder.

[fols. 859-862] The Court: Answer the question and then give any explanation you wish.

The Witness: I was not interested in, and have not been interested in the picture from the standpoint of a stockholder, or getting anything on the stock I own; but primarily interested in seeing this company continue in business.

Mr. Palmer: If the Court please, I don't believe that is a fair answer to my question.

The Court: No; answer the question.

(Question read to the witness.)

A. I certainly understood there was not any possibility of realizing anything on the stock.

The Court: All right; now proceed, Mr. Palmer.

Mr. Palmer:

Q. Now, with that realization, with you and every other man in that room having that realization, nevertheless you voted for a resolution to put the company into a reorganization plan; did you not?

A. I voted for it.

Q. And it was voted for by every other man in that room?

A. That is right.

* * * * * * *

[fol. 863] ALLEN G. MESSICK, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. Give the Court your name, please.

A. Allen G. Messick.

Q. Where do you live?

A. Chicago, Illinois.

Q. Did there come a time when you had some business relationship with Fidelity?

A. There did.

[fol. 864] Q. When did you have your first contact with Fidelity, Mr. Messick?

A. About a year ago, or a year and a half ago.

Q. Where was that?

A. In Chicago, Illinois.

Q. Did you have a continuing relationship from that time on until you were elected chairman of the board?

A. I did.

Q. Briefly detail to the Court the character of your relationship and what occurred between your first contacting Fidelity or Fidelity contacting you, and up until the time you were elected chairman of the board of directors of Fidelity.

A. Mr. Pulfer met me on an occasion of a social meeting in Chicago.

Q. Did he present the Fidelity matter to you?

A. Yes.

Q. And then what happened? Did anything grow out of that meeting?

A. Out of that meeting we entered into a contract. Out of the conversation there we entered into a contract with Fidelity Investment Association wherein, after certain stipulations, we were to invest $500,000 in that venture,

[fol. 865] Mr. Rosset and I. We made considerable investigation on the representations made and at the end of considerable time came to the opinion that it was not safe at that time, it was impractical to go through with the contract for the reason that the evaluation of the portfolio, we differed in that evaluation as originally submitted; and it would involve—the corporation would be involved, in our opinion, in endless litigation, and also during that time the association was suspended from doing business in the State of Illinois and the State of Michigan, and others.

Q. The name of the corporation at that time was what?

A. Fidelity Investment Association.

Q. So that nothing was done about the rehabilitation at that time?

A. No, that is right.

Q. As I understand, the rehabilitation contemplated the putting in by you and Mr. Rosset of half a million dollars in new money?

A. That is right.

Q. And that was to be done under the conditions of the contract?

A. Yes.

Q. And after you had valued the portfolio and carefully [fols. 866-871] scanned the situation of the company and its business as it was being carried on at that time——

A. That is right.

Q. —you withdrew from your proposition, did you not?

A. That is right.

Q. Had that cost Fidelity anything? That is, did Fidelity expend any money by reason of your having entered into negotiations with them?

A. No, not to my knowledge.

Q. There was a certain amount of stock that was to be delivered; is that right?

A. That is right.

Q. Was the amount of stock agreed to be delivered ever delivered?

A. No, it wasn't. It was impossible. They could not deliver it.

Q. They were not able to gather up the amount that was to be delivered?

A. No.

* * * * * * *

[fols. 872-873] Q. And what amount were you to receive a month as chairman of the board?

A. They fixed my salary at $1,000 per month.

Q. Was Mr. Risley elected president of the company at the same time?

A. No, prior to that time.

Q. What was to be your capacity of work which you were to perform for the company?

A. I was to endeavor to rehabilitate and reorganize the company along the lines either by voluntary reorganization, if possible, of securing a uniform contract, and could make a complete revision of the portfolio and in general endeavor to rehabilitate the company.

. . . . . .

[fol. 874] Q. What else did you endeavor to accomplish during that period of about four months?

A. As I say, we went into the legal complexities of these various contracts, as stated in my letter, which I assume you will file; insisted on a complete disclosure, and to that end I talked first with Mr. Baines, I believe it was, of the Securities and Exchange Commission, stating frankly that we were wishing to reorganize Fidelity for the benefit of the people concerned, the contractholders, and then we later, some months later, as our plans progressed, we had our attorneys submit our proposed outline and plans of reorganization to the Securities and Exchange Commission in Washington and simultaneously with the Auditor of West Virginia here.

[fol. 875] Q. What did that comprise, Mr. Messick, briefly?

A. It comprised of taking every fund, segregating every fund as stated on our books, and evaluating them on a market basis and asking the individual contractholder to accept either a lien or a reduction in the amount due him according to the respective value of such fund as evidenced by the market value of securities in the fund.

Q. In other words, you evaluated the securities in each fund and you intended to allocate to each contract holder his equitable interest?

A. That is right.

Q. In that particular fund, whatever it might be; is that right?

A. Yes, and advising him of the exact situation and giving him the bookkeeping of that particular fund, if the Auditor and the SEC said that was satisfactory.

Q. Then in addition to that did you have the corporate charter amended?

A. We were of the opinion and advised that Fidelity could be converted to write insurance in addition to their savings plan contracts, and to that end we had the charter amended.

Q. And under that charter you intended writing insur-
[fols. 876-882] ance in addition to the business you had already been carrying on?

A. Yes.

Q. But as I understand, you never wrote any insurance, did you?

A. No, because the Auditor of State made an examination of us and had us under examination during that period and at the time of making — of asking the advice of the Securities and Exchange Commission, why, it became necessary in the judgment of the Auditor to file this action.

Q. Now, you spoke of having this portfolio evaluated by these various large banking institutions and their making recommendations for the changing of the various portions of that into what they thought was more advisable and better balanced securities; did these people you consulted make any charge to the company for their services, Mr. Messick?

A. The Continental Bank—well, all those respective institutions charged the company nothing.

. . . . . .

[fol. 883] Q. And Mr. Koontz advised the bringing of this proceeding in the state court in order that the affairs of the company might be rehabilitated; is that right?

A. Yes.

Q. And is that the reason the board of directors authorized or at least consented to the bringing of the suit, Mr. Messick?

A. We employed Mr. Koontz as our attorney to represent the company and endeavor to see that the proper reorganization was brought about for the benefit of the contract holders.

Q. After the state court receivers were appointed did you endeavor to cooperate and assist in every way possible?

A. I did to the fullest extent.

Q. In working out a reorganization?

A. That is right.

Q. And you spent time on that?

A. I did, considerable.

Q. What did you find in reference to it being very diffi-
[fol. 884-885] cult if not impossibe to move forward in view of the fact that there were a number of other state court receivers other than the receivers in the state court of West Virginia?

A. Owing to the authority of the state court, of course, stopping at the State line, the receivers—for example, in Wisconsin the receivers were maintaining one position; in Pennsylvania the receivers were maintaining another position, and so on in other states, so that they were conflicting and there were legal contentions that were conflicting, so that it appeared that the only solution to reorganize this company was to place it in a court under a central authority with jurisdiction over all.

Q. And with that idea in mind did you call a meeting of the board of directors in Pittsburgh on June 3, 1941?

A. I did.

. . . . . .

[fol. 886] Q. And who were present at that meeting?

A. Mr. John Marshall, Sr.; Mr. John Marshall, Jr., Mr. Howard E. Reed of Pittsburgh, Pennsylvania; Mr. F. H. Pulfer, Chicago, Illinois; Mr. A. L. King of Wheeling, West Virginia, and you were present by invitation, and Mr. McNulty. I believe that is everybody.

Q. And yourself?

A. Yes, of course.

Q. State briefly what was done at that meeting, Mr. Messick.

A. At that time, at that meeting, we convened and had a resignation from Mr. Foulk sent there, Thomas B. Foulk, and we elected Mr. Fleming to fill the vacancy and convened the meeting, the formal meeting, and considered the situation; a discussion for some hours, discussing the situation and decided to petition the United States District Court of West Virginia for reorganization.

Q. Something has been said about your bringing a resolution already prepared into that meeting for the purpose of having it adopted.

A. I brought no resolution and to the best of my recollection you dictated a resolution to the stenographer at the

[fol. 887] William Penn Hotel, when the meeting was recessed.

Q. And that resolution was later brought to the meeting while it was still in session?

A. That is right. We recessed and you went down and prepared the resolution.

Q. Then the resolution was voted upon?

A. That is right, the resolution which you prepared.

Q. Were there any opposing votes to that resolution in the meeting?

A. To the best of my recollection there were no opposing votes; unanimously carried.

Mr. Palmer: I will have to object. The minutes show that A. L. King did not vote, and I think attempting to impeach the minutes of the alleged meeting would be improper, by this witness.

The Witness: I thought Mr. Fleming's question was, was there any objection to that plan?

Mr. Fleming: That is what I thought I said.

Mr. Palmer: The record shows A. L. King did not participate.

The Court: I think the objection will be sustained as to that part of the answer attempting to contradict the minutes.

Mr. Fleming:

[fol. 888] Q. After that the meeting later adjourned, did it not?

A. Yes.

Q. And the petition was later filed in this district?

A. Yes, that is right. In the earlier part of the meeting Mr. McNulty attended as secretary.

Q. Tell us about that.

A. He brought the minute books and the vacancy was suggested and that Mr. McNulty be elected a director, and Mr. McNulty stated that he was a man who had to work for his living and he didn't feel like he could be a director of the company and at the same time be employed by the receivers, and on that statement he withdrew from the meeting and Mr. King was elected secretary of the meeting.

Q. Who were the members of the board of directors at that time?

A. It was Mr. F. s. Risley, Mr. Austin King——

Q. What about Mr. Burt?

A. Mr. Burt, yes, of Wheeling.

Q. Well, Mr. Burt and Mr. Risley were absent?

A. They were absent.

Q. And they were the other directors?

A. Yes.

Q. How did you arrive at that number? I think the min- [fol. 889] utes of the stockholders' meeting of that year, or the year previous, showed the election of 14 directors.

A. That is right, but a number of the men elected as director did not qualify.

Q. Refused to serve?

A. Yes.

Q. And that left these eight?

A. That is right; that left eight.

Q. At the time this meeting was held there were only eight directors?

A. That is right.

Q. And six of those were there?

A. Yes, six were there.

Q. How did it happen Mr. Burt did not come?

A. Mr. Burt informed us he was attending a telephone meeting at Charleston.

Q. What about Mr. Risley?

A. Mr. Risley, I was informed, wired he was unable to be there.

Q. In your judgment, from your experience with the affairs of Fidelity and your general business experience, do you feel that the affairs of Fidelity could be rehabilitated and a plan of reorganization developed that would be fair [fols. 890-899] and equitable and beneficial to the contract-holders?

A. I do.

Q. Explain that to the Court, please.

A. I feel that there is an inherent worth in the Fidelity idea; that is, of compulsory savings, and with that loyalty, if a plan is evolved that would make a return in line with present conditions—that is, it would be impractical in my judgment to have a reorganization plan that would pay 4%, 4½ or even 3%, I mean on establishing a reserve interest, but I do think that a reorganization could be accomplished if the portfolio was evaluated on a rock-bottom basis and if any changes necessary to convert the same, that is, take

away the speculative issues, were made, and then make the reserve return consistent with what the return on the securities was.

Q. That is, the present day earnings?

A. Present day evaluation; and in addition to that to also combine the new feature with it.

Q. And you think with a situation of that kind a plan could be developed, that is, could go forward successfully for the future?

A. I think so.

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[fols. 900-911] Mr. Palmer: Was there less than 60% of the common stock alone obtained, Mr. Marshall?

Mr. Marshall: I am not sure about that.

Mr. Palmer:

Q. Mr. Messick, it also says, "provided, that at the discretion of the parties of the second part, such a deposit of 50% of each class of stock may be deemed sufficient compliance herewith."

A. If we deemed it sufficient, I don't remember the provision exactly, but I think we could waive 60% and go down to 50%, yes. I don't remember that exact wording but of course that is right.

Q. You never waived that?

A. No, for the reason that our attorneys in Chicago stated that it seemed—I don't know, Fidelity said they would have to go outside the state of West Virginia to secure others, and our attorneys insisted on a registration, I believe, or consent of the Securities and Exchange Commission to solicit—I am not clear; some legal point which we would not waive.

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[fol. 912] Q. You did have several conferences with the Securities and Exchange Commission?

A. As I say, the plan of reorganization was a matter of full and complete disclosure to the Commission.

Q. It was impossible to give any practical plan?

A. No. I was not present at all the hearings. I helped prepare a lot of material and was in Washington at the time the Securities and Exchange Commission's position

was communicated to me by Mr. Calvert—I am not sure, I believe that was his name—which was that they were sympathetic to reorganization but in their judgment they did not think reorganization was practical, a voluntary reorganization was practical or equitable; that it had to be done by court procedure.

Q. Let me see if I understand your voluntary reorgani- [fol. 913] zation plan. Was it this: you were to value in each series the market value of every asset in that series; is that correct?

A. No, we were to do this: We were to put on a market basis—take every series on a market basis; then to lock up that fund and if there was any appreciation the contract holder got the benefit, but he was apprised at that time that the market value of that fund was "X" dollars and his equity was so much.

Q. Now against each series there were certain liabilities?

A. That is right.

Q. And you were going to write the contractholder and say we have so much, and so much liability?

A. That is right; that was the plan.

Q. And therefore, instead of your having $100 right against this fund, although you have a right to $100, we will have to scale it down to $50 or $75 or whatever your equitable share is?

A. Well, the thing was, it was just to give him a frank disclosure of the market value of his particular fund.

Q. Well, there were some funds that did not have as much money?

[fol. 914] A. There was a variance, yes.

Q. So that you were going to have to tell them, although you have $100, a contract for $100, we have only got $10 for you with which to pay it?

A. Nothing that extreme. We were going to tell them the truth about it, the true market value of the securities. That was what we were going to do.

Q. And tell them what their share as compared to others of that same fund was; isn't that right?

A. I don't understand.

Q. If the fund had $100,000 security market value, and it had $200,000 of contractual liabilities against it, you were going to tell each person that instead of his having on his contract what it called for you had only 50%, because you were going to divide that fund equitably among all?

A. We were going to make a full and frank disclosure, a complete bookkeeping statement of the various funds; I mean "X" number of contractholders in this fund, "X" number of assets, market value so much, and lock them up and hold them separately until—after he was apprised of the condition of the fund, his opportunity for cash surrender, then ask him if he thought it was better to go into [fols. 915-919] voluntary reorganization and take a chance on appreciation.

Q. That did not go through?

A. For the simple reason they felt, rightfully, that a voluntary reorganization of any kind—not just this one plan; there were several. Your firm worked very hard, Mr. Koontz gave it considerable time, he and I worked very closely on it and submitted it informally, not as a body, they were just helping us, the SEC, not hearing it formally, but they thought it was possible to be reorganized but it could not be reorganized except by means of a central jurisdictional authority.

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[fol. 920] Mr. Palmer:

Q. Now, Mr. Messick, I understood you to say that just before the matter went into the state court Mr. Arthur Koontz was employed by the debtor to represent it in that proceeding?

A. Yes, we employed him at Wheeling.

Q. Now, the matter was handled in state court, and is it not a fact, and it has been so testified, that with the exception of one contract holder who intervened in the Kanawha County Circuit Court for the purpose of ascertaining what plan, if any, would be produced, there was not a single contractholder protested to the Circuit Court of Kanawha County concerning the handling of those affairs in receivership? Did you know that?

A. I don't know, no. I am not familiar with that.

Q. But without discovering that fact, that there had not been a single contractholder protest to the Circuit Court of Kanawha County, you nevertheless called a meeting to be held in Pittsburgh?

Mr. Fleming: I object as not pertinent or relevant and having nothing to do with the issues, and it is not cross-examination.

[fol. 921] The Court: Sustained. I do not see the slightest relevancy.

Mr. Palmer: If the Court please, I want to show the question of good faith of the debtor as represented by the board of directors, in that so far as the members who testified are concerned they have all testified they were interested in the contractholders, and that the reason that meeting was held in Pittsburgh, and the reason they filed this proceeding, was to protect the contractholders. Now, I want to find out about that meeting and what interest they had in the contractholders, and particularly the chairman of the board.

The Court: I do not think the fact that the contractholders had or had not written letters has anything particularly to do with that, and I will sustain the objection. (Exception.)

Mr. Palmer: May I make an offer of proof on the record of what the witness' answer would be?

The Court: You may state briefly whatever you want to on the record.

Mr. Palmer: The offer of proof is simply that the witness would answer yes to that last question.

* * * * * * *

[fol. 922] Q. Now, Mr. Messick, Mr. Fleming had been an old friend of yours; is that right?

Mr. Fleming: I am not ashamed of that, but it has nothing to do with the issue in this case.

[fol. 923] The Court: I will let that go in, but narrow it as much as possible.

A. That is right.

Mr. Palmer:

Q. At your suggestion he was at that meeting; is that right?

A. I invited him to that meeting, yes.

Q. And at that meeting he was selected the attorney for the company; isn't that right?

A. He was selected to file this bill.

Q. As attorney for the company?

A. In this particular instance, or this particular undertaking, that is right.

Q. At that time you had an attorney for the company representing you, Arthur Koontz, did you not?

A. Well, I don't know.

Q. I beg your pardon?

A. I mean, the point is this: We were informed in Washington that Mr. Koontz said that Mr. Sims would select or wanted an outstanding business man in West Virginia, and then a member of your firm—they were receivers. And then Mr. Koontz or Mr. Goldsmith or somebody here was representing the receivership, and I did not think that we could ask your firm to assume this burden too.

[fol. 924] Mr. Fleming:

Q. Let me ask you there: Is it not a fact that both Mr. Koontz and Mr. Wood were invited to attend that meeting, the same as I?

A. Definitely so, as was Mr. Thomas B. Foulk.

Mr. Palmer:

Q. Did you tell them the purpose of the meeting?

A. Definitely I did.

Q. You told them the purpose was to file a bill in federal court?

A. No, I did not tell them the purpose was to file a bill in federal court, but to consider the reorganization and all plans necessary for the reorganization.

Q. Had Mr. Fleming been your personal attorney?

A. Never.

Q. You brought an old friend of yours to the meeting and had him, who had never had any connection with Fidelity before, elected the attorney to bring the proceedings; is that correct?

A. For the reason Mr. Fleming had been United States Attorney for eight years in the State of Indiana, had been a leader in and had consummated some of the leading reorganizations in this country, and on that basis I asked him to come.

[fol. 925] Mr. Fleming: I move that the answer be stricken out, your Honor.

The Court: Overruled.

Mr. Fleming: I don't think I am a party to this proceeding yet. It is true I was elected a director, and I have been

embarrassed about that many times, but it seems to me——

Mr. Palmer: I am sorry we have to inquire about it, but certain issues are raised by our answer and we feel we have to go into it.

The Court: You may proceed.

Mr. Palmer:

Q. After that meeting who prepared the bill which was filed, if you know?

A. Mr. James Fleming, I think.

Q. Did you help him in any way?

A. No, I did not.

Q. Did you come to Charleston with Mr. Fleming when the bill was filed?

A. I did.

Q. On the morning of June 7, 1941, the Trustee qualified as such by accepting the trust and giving bond immed-ately thereafter and on the same morning it selected and recommended its general counsel to aid and assist in the adminis-[fol. 925a] tration of the trust.

Mr. Fleming: I object to that for the reason that is certainly a very moot question. Unless there is some matter of good faith or some matter or form of imposition that was practiced upon the Court, or upon someone, I fail to comprehend how this could have anything to do with the issues presented here.

Mr. Palmer: I will connect it up immediately.

The Court: I am assuming it is offered as bearing on the question of good faith, and it might have some bearing on that question, so I will admit it.

Mr. Palmer: And is not this true, that the Trustee filed a petition for authority to employ James B. Fleming and A. G. Messick, "for the purpose of assisting your Trustee in marshalling the assets of said debtor which are now situate in divers states outside the territorial limits of the State of West Virginia, and also for the purpose of assisting the Trustee in the development and formulation of a plan of reorganization for the affairs of debtor in this proceeding * * * and that this authority is requested under Section 157 of Chapter X of the Federal Bankruptcy Act." Is that not true, Mr. Messick?

A. Yes.

[fol. 926] Q. Had you requested the Trustee to so employ you?

A. No, I had not requested it.

Q. And is it not a fact that thereafter you and Mr. Fleming acting under such employment went to the State of Wisconsin and there conferred with the Banking Commissioner of Wisconsin?

A. We conferred—we went to Wisconsin, that is——

Mr. Reinhardt: Just a moment. If the Court please, I feel obligated at this point to point out that this question assumes a fact which the record, so far as I recall, does not establish yet, and that is that Mr. Messick was employed by the Trustee under the order permitting the Trustee to employ him.

The Court: That has not only been shown, but definitely stated by the Court, that no such employment was ever made.

Mr. Palmer: I want to ask Mr. Messick the question I last asked, however, if he did not go with Mr. Fleming to the State of Wisconsin.

The Court: You are asking him whether he went under that employment?

Mr. Palmer: That is what I would like to cross-examine Mr. Messick about, if the Court please. I don't want to [fol. 927] contradict the Court, naturally, but——

The Court: I don't think I will permit you to cross-examine anybody on a statement I make, and I do make that statement on the record, that there was no employment because I entered an order that there should not be.

Mr. Farmer: Then if he was just acting unofficially and as an interloper, we have a right to go into that.

The Court: All right, ask him that question.

Mr. Fleming: I object. How would that affect the issues here, anyway?

The Court: I will admit such a question as that, if it is asked. (Exception.)

Mr. Palmer:

Q. Did you go to the State of Wisconsin with Mr. Fleming and confer with the State Banking Commissioner and Mr. Lauritzen here?

A. I did.

Q. Did not you tell them you were employed by the Trustee at that time?

A. I think we stated we were authorized by the Trustee —I don't think Mr. Fleming or myself had any idea of any compensation for these services, as a matter of employment. We were doing the best we could to help.

Mr. Palmer: If the Court please, with that statement [fol. 928] may I pursue my cross-examination as to the employment wherein they stated they were authorized?

The Court: No, not as to employment, but you may pursue the examination as to what he did.

Mr. Palmer:

Q. What did you do there?

A. We had a conference and asked the department of Wisconsin to aid in reorganization.

Q. Aid the Trustee in a plan of reorganization?

A. That is right.

Q. Did you ask that the assets be turned over to the Trustee?

A. At that time, no, I don't recall; I don't know.

Q. The general tenor of the conversation was to ask the Banking Commissioner of Wisconsin to cooperate with the Trustee in reorganization under this Court?

A. And to cooperate with the Trustee, yes.

Q. Did you go with Mr. Fleming the following day to Chicago to the meeting of the commissioners of all states?

A. I was not with Mr. Fleming in that meeting.

Q. You went to Chicago with him but did not go to the meeting with him?

A. That is right. I was not in that meeting with him.

Q. Did you receive your expenses for that trip to Wis- [fol. 929] consin?

A. I did not.

Q. From anyone?

A. No.

Q. Have you made any claim for that as yet?

A. I have not.

Q. Were you authorized by the Trustee to represent it in Wisconsin?

Mr. Fleming: The debtor objects. I don't see how that is relevant. If Mr. Messick or myself had done anything that injured anybody, why, that would be something else;

or if any money had been paid out to us or anything like that, that injured anyone, that might be a different situation.

Mr. Palmer: Perhaps but for the intervention of Mr. Wood there might have been money paid out.

Mr. Fleming: Suppose there had been, Mr. Palmer, for expenses or for services, are you impugning the ability and the honesty of this Court by assuming that this Court would order the Trustee or anyone else to pay out money to Mr. Messick or myself unlawfully?

Mr. Palmer: I think the question answers itself. I impugn nothing wrong to the Court.

Mr. Fleming: I think you are. I think so, and if I have [fol. 930] done anything that has injured anyone I would like to know it, and if Mr. Messick has done anything to injure anybody, I would like to know that.

The Court: The Court does not consider Mr. Palmer's question is any imputation of anything with reference to the Court, but the Court does say that the question of employment is settled on the record. There is no such. Now, as to whether the Trustee authorized Mr. Messick to talk to these people, I do not see how that has anything to do with this case.

Mr. Palmer: If the Court please, the answer of the Auditor sets this up; that Mr. Messick came into this company without any interest and got a salary of $1,000 a month until the Auditor stopped it; that after the state court proceedings had been brought Mr. Messick, without contacting the contractholders in West Virginia, called a meeting of the board of directors, which the answer of the Auditor sets up as an illegal meeting, and that in that meeting Mr. Messick brought with him a friend of his, an attorney, and Mr. Messick then had a petition filed in federal court although there had not been a single protest in the state court in Kanawha County against the receivership there; that following that plan Mr. Messick came down here, presented [fol. 931] this petition to the Court, who, of course, accepted it on its face value and appointed a disinterested trustee and a disinterested attorney, and immediately following that the trustee presented an order for the employment of these two gentlemen who caused this proceeding to be brought, and immediately following that these gentlemen went to the State of Wisconsin and to Chicago, Illinois, to

the meeting of all insurance commissioners, in pursuance of that very plan set forth in this answer; and that plan is this, that the only possible way that could be thought of to get all of the assets into one court would be this: if a voluntary petition in bankruptcy were brought the law provides that the lienholders work out that matter themselves and turn over the proceeds to the bankruptcy trustee. If, however, a reorganization proceeding is brought the statute can be construed that one trustee can get all the funds in its hands and then if no plan can go through, having taken that money from the state depositories it will be turned over to the trustee in bankruptcy on order though by the persons who brought this proceeding.

The Court: I don't understand what you mean by "on order though by the persons who brought this proceeding." Do you think they would run the Federal Court?

[fol. 932] Mr. Palmer: No, your Honor, of course not.

Mr. Fleming: Then why do you say that? You are a man of intelligence, and why do you say that? I object. I have not assumed to do anything that would hurt anybody, certainly not to take any money off of anybody. I came before this group in Chicago, and I think probably some of you gentlemen were there, and I told them, I think, very plainly that I did not assume to represent the Trustees. Isn't that right, Mr. Jarecki?

Mr. Jarecki: As I recall. I don't recall exactly, Mr. Fleming.

Mr. Fleming: But whether I did or not, it is not important. What is there of importance about that, if I was acting in good faith, trying to do the best I could for everybody, why should I be, as it were, attacked?

Mr. Palmer: When Mr. Messick, the man who had no interest financially in Fidelity, calls a meeting of persons who had no interest in it, because their stock rights were entirely gone, for the purpose of taking it out of a court where there was no protest concerning it by the contract-holders, and bringing it into another court, and the following morning he himself and the attorney he has brought to that meeting are appointed by the Trustee for the duration of that [fol. 933] trusteeship to aid that trustee, we have a right to question the motives of that chairman of the board in calling that meeting and in filing that petition, and that is what we are doing, if the Court please.

Mr. Fleming: I don't think you are doing it successfully.

Mr. Palmer: That is not for you to judge.

May I ask a question about your appearing before that meeting in Chicago? Were you told and directed by any official of the Trustee to go out to Chicago and attend that meeting?

Mr. Fleming: No.

Mr. Palmer: You just went of your own accord?

Mr. Fleming: Yes, sir. Just as you might have gone, as representing contractholders, I went representing the debtor, and I endeavored to be fair with the people there, and I particularly appreciated the fine, generous spirit with which I was treated at that meeting.

The Court: So far as Mr. Fleming's going to that meeting, or any other meeting, in and about the business of trying to work out his reorganization plan that he has filed here—I don't mean his reorganization plan, but to advance the interests of the reorganization that has been petitioned [fol. 934] for—I cannot see any difference between that and the appearance of Mr. Farmer here today in this Court, or Mr. Palmer's appearance here today. Mr. Fleming is the attorney for the petitioning debtor and you gentlemen are attorneys for certain people who are opposed to the approval of the petition. Why should there be any argument on the record with reference to those things?

Mr. Palmer: I will be glad to disclose the reason I had in mind, that it was the day following the entry of this order, or a day or two afterwards, authorizing the Trustee to employ Mr. Messick and Mr. Fleming that they appeared in Wisconsin, and, as Mr. Messick says, informed the Banking Commissioner there—What was the exact wording he used with reference to the Trustee, Mr. Reporter? That he was authorized to——

Mr. Fleming: Just a moment. I will say why I went to Wisconsin, and it was without any obligation on the part of the Trustee or Mr. Townsend. Mr. Townsend called me by telephone. The Wisconsin authorities were about to sell securities and we went up there, rather a committee, because I was requested to go up there; and I went up without any obligation on the part of the Trustee or Mr. Townsend or anyone else, and I paid my own expenses and I was glad [fol. 935] to meet the Wisconsin authorities. I thought their attitude was both intelligent and generous. That is what I thought about the attitude of the Wisconsin authori-

ties, and after that I found that same situation in Chicago. Tennessee told me that they were going to hold on to these securities until virtually the last dog was dead, and I think they meant it, but I want to say that when I walked into that meeting I felt a spirit of great hostility toward me as the debtor's attorney, and when I left I felt that at least I had had a friendly hearing, to which I was, I thought, entitled.

The Court: Well, I think this argument has proceeded far enough. Is there anything further with Mr. Messick?

Mr. Palmer: If the Court please, may I have this question on the record——

The Court: If you have a question, yes; otherwise, just argument, no.

Mr. Palmer: Mr. Fleming stated he was asked to go to Wisconsin. I want to ask him what person asked him, and whether that person was connected with the Trustee, to go to Wisconsin.

Mr. Fleming: Yes, Mr. Townsend called me by telephone and I went without any obligation on the part of anyone, and I did the thing I thought was best for the debtor and [fol. 936] for the Trustee and for the contractholders, and for everyone connected with this proceeding.

Mr. Palmer:

Q. Mr. Messick, I had asked you, I believe, and as I recall you answered, that in appearing before the Wisconsin Banking Commission you told the Commission you were authorized by the Trustee to appear there to talk with them.

Mr. Fleming: I object.

The Court: Overruled. (Exception.)

A. I drove Mr. Fleming up there to meet with the Banking Commission. Mr. Fleming communicated to them the purpose of our visit, as I recall.

Mr. Palmer:

Q. Did not I ask you on the record, and did not you state, that you told them you were authorized to appear there for the Trustee? Didn't you answer that just a few minutes ago?

A. If I did it was a mistake. I mean I had no capacity there; just a friendly discussion with Mr. Fleming and we might have said—I don't really recall, except we were

trying to abate that situation, get Wisconsin to cooperate with us and not sell these securities.

Q. "With us"? Whom did you tell them you were representing?

[fol. 937] Mr. T. C. Townsend: Your Honor, I object. I think this has gone far enough, and entirely beyond the bounds of cross-examination.

The Court: Overruled. (Exception.)

A. I don't recall.

Mr. Palmer:

Q. As a matter of fact, did not you tell them you represented the Trustee in reorganization? Answer that question yes or no, please.

A. I don't recall; just a friendly meeting, an informal meeting.

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[fols. 938-939] Q. Now, what chance would such a contract have in being sold as against defense bonds which yield 2.9, and which have the backing of the United States Government?

A. In my opinion, I think the thing that sells these contracts is the savings feature. I don't think the interest requirement—and I am advised by several leading salesmen to that effect—I don't think the interest feature is of the greatest interest. The compulsory savings feature is the idea.

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[fol. 940] Q. And whether it is like a Christmas Club, with no interest, but compulsory or semi-compulsory, a systematic savings plan, you think that would work?

A. Yes, sir; I do.

Q. But you cannot see where there would be any profit in it for any one to invest money in it?

A. No, I definitely think a company can be founded on compulsory savings and yield a safe return.

Q. My thought is this, that a person who would put up capital for such company would have no chance to make any [fol. 941] money because the yield would be so low even to the investor that——

A. (Interposing:) Oh, no, they could make money, a very conservative yield; and I think capital stock would be rated, if you can rate a common stock equity, as a conservative investment.

Q. You would not put your $500,000 into Fidelity as it was, would you?

A. As it was, on a 4½% return, no, because the record shows you cannot do it without investing in speculative securities.

Q. And it required, as you found out from your investigation, an expensive sales campaign with heavy expenses to put it over, did you not?

A. I don't agree with that. I was very critical of that.

Q. You found out that is what they had done, didn't you?

A. No, their sales—their past history was that they had spent more than I would have; what I called promotional sales.

Q. That is what I mean, their past history shows, right or wrong, that they had spent a very heavy sum for pro- [fol. 942] motional sales?

A. That is right, in my judgment.

Q. And that regardless of whether it produced results or not, they spent too much, in your opinion?

A. In my opinion I think that the company had no chance on that high yield that was expected and the excessive promotional sales expense.

Mr. Palmer. That is all I care to ask, your Honor.

By Mr. Lauritzen:

Q. Mr. Messick, when you and Mr. Fleming came out to Wisconsin you had a discussion with the Chairman of the Banking Commission of Wisconsin and myself, did you not?

A. Yes.

Q. And various plans and prospects were discussed and you wanted to get our attitude and you conveyed to us something of your attitude; is that correct?

A. Yes, it was an informal meeting; thinking out loud.

Q. You expressed the idea there that you were fully aware, in order for this company to get anywhere in the future, they would have to have the full sympathy and cooperation of the various states in which they operated, including Wisconsin; isn't that right?

A. Yes.

[fol. 943] Q. You testified a while ago as to a voluntary reorganization you had been turning over in your mind and had discussed with the SEC or others?

A. I did.

Q. Of segregating everything into funds and telling everyone what they had and then frankly putting it up to them and having them write it down on a re-listed basis?

A. That was the plan, one of the plans suggested. Several were suggested.

Q. In connection with the loss on such a plan did you consider whether such a plan could be put over in states where the contracts were 100% secured by the deposits made for that express purpose in those states? Did you feel that in some way that deposit there could be abrogated and that you could get the contractholders to write down their equity in the particular fund upon some voluntary plan or other?

A. We felt like this in regard to particular states, as regards particular classifications of contracts, I mean, of the five or six they had, we were going to submit a voluntary plan based on the cash surrender—an option of doing such and such. It was not regarded as any state jurisdiction but as regards the particular classification of the different contracts.

[fol. 944] Q. Then you did not consider that that would perhaps be impossible with respect to contractholders who were 100% secured in particular states, or did you?

A. That is the point where lawyers differ. I have asked several lawyers as to the various rights of various states, and I don't know.

Q. If it was a fact that contractholders in some states were absolutely secured to the full extent of their contracts by deposits in those states, then even such a voluntary plan as you proposed and had discussed would necessarily fail, would it not?

A. I would think so. I don't know the final figures, so many securities have depreciated, but I would say this: Certainly if one state is in such position that they would get 100%, I would think they would take the 100%. I have no opinion really because I think it is a question for a court to settle.

Q. But assuming that they had the 100%, that would be the result, wouldn't it? That is, you could not expect a man to come in and scale down if he had 100% in his own state,

could you? You couldn't get him to do that, could you, Mr. Messick?

A. I guess that is obvious, isn't it? I would think so, [fols. 945-947] yes, but it is also a question of law.

* * * * * * *

[fol. 948] By Mr. Farmer:

Q. May I infer from your answers that you have moved around in financial circles to a considerable extent, Mr. Messick?

A. Well, to a modest extent, yes.

Q. Among the banks of New York, Chicago and other places?

A. Well, I have friends and I guess I am known there.

Q. And you have promoted the Farnsworth Television Company?

A. I was one of the organizers of the Farnsworth Television Company.

Q. And the other company back of that was the General Household Utilities?

A. I had nothing to do with the promotion of it. I represented various financial interests which advanced money to that corporation.

Q. Capital?

A. That is right. I mean loaned money, not invested capital.

Q. What was the business of that company?

A. Manufacturing refrigerators and radios and electrical appliances.

Q. When did you first become connected with that com-[fol. 949] pany?

A. 1934.

Q. Prior to that time what business were you in?

A. Prior to that time, until 1934—the latter part of 1930 to 1934—I was with Mrs. Messick during her last illness in California, an inactive time; and prior to that time I was organizer and chief executive of the United States Radio Corporation, which made radios for General Motors; and prior to that time I was a lawyer and interested in various manufacturing institutions.

Q. Where did you practice law?

A. Marion, Indiana.

Q. What years?

A. I practiced from 1912 to 1927.

Q. Then you gave up the practice of law there and went into the manufacturing business?

A. That is right.

Q. With the United States Radio Company?

A. Yes.

Q. Did you organize and promote it?

A. Organized it and one of the principal stockholders.

Q. You put your money in it?

A. I did.

[fol. 950] Q. And got other people interested in it?

A. A local enterprise.

Q. Is that still functioning?

A. It is now part of the Farnsworth company, the Marion plant.

Q. You merged them or something?

A. Yes, we merged them.

Q. Well, you have talked over this Fidelity situation, I take it, with bankers in New York and Chicago and all these other places you have been, when you went over the portfolio; is that right?

A. Yes, I have, generally.

Q. That is, the troubles they were having?

A. Well, it was a matter of general knowledge pretty well around; in the papers.

Q. You mean the bankers already knew of the company?

A. Yes.

Q. And of their trouble?

A. Yes, sir; I think every bank of any size has a credit file on Fidelity.

Q. Were you contemplating then putting new money, new capital, in the company?

A. We contemplated putting additional money in the [fol. 951] company.

Q. And for how many years have you been turning that over in your mind?

A. When I first started it was a year and a half ago.

Q. A year and a half ago?

A. Yes.

Q. And that is common knowledge among banking circles?

A. I don't say common knowledge. I don't think I am that important. I would say among the people I know.

Q. That is, people who have money to invest?

A. No, people that know me, that I have talked to, prob-

ably know I have been active there. I don't think I am important enough to be common knowledge.

Q. You did not consider at Pittsburgh when you adopted this resolution to try to get the company reorganized down here, the possibility of putting new money into it?

A. We discussed that. We considered everything from time to time, but as I said, I don't think Fidelity on this present set-up of high interest yields can be economically and safely run. I think it needs to be reconstructed and reorganized.

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[fol. 952] HARRY B. HOBSTETTER, having been first duly sworn as a witness, testified as follows:

Direct-examination.

By Mr. Fleming:

Q. What is your name, please?
A. Harry B. Hobstetter.
Q. Where do you live?
A. Wheeling, West Virginia.
Q. Are you employed by Fidelity?
A. Yes, sir.
Q. How long have you been employed by Fidelity?
A. Twenty years.
Q. When did you first enter the employment of Fidelity?
A. In September, 1920.
Q. In what capacity?
A. At that time I began as a clerk.
[fol. 953] Q. In what department?
A. In the posting department.
Q. Just explain to the Court what progress you made from time to time, and what changes were made in the course of your employment.
A. Well, from that time on I advanced through every department in the association until eventually I was made office manager by the president of the company and the chairman of the board.
Q. How long have you been office manager?
A. Since April, 1940.

Q. Briefly tell the Court what your duties were as office manager.

A. Well, I was in charge of the operating division. That meant that it was my job to see that the affairs of the association were handled in an efficient way; for instance, the mail, when it came into the office was supposed to be handled the same day that it came in, if possible, and all collections that were received from contract holders were put through promptly; to see that the postings were made promptly, and correspondence answered by the people in charge of answering the correspondence.

As a matter of fact, it was my duty to see that the opera- [fols. 954-966] tions of the company did not hit a snag and that they were handled in an efficient manner.

Q. Prior to your becoming office manager, what did you do?

A. I answered correspondence chiefly.

* * * * * * * *

[fol. 967] Mr. Lauritzen: This does bear on the issues raised by our answer, the fact that the petition here was signed by John Marshall, Jr., and I just wanted to ask as to the office he held and the nature of the duties.

The Court: All right; go ahead.

Mr. Lauritzen:

Q. Will you answer the question?

A. Did you ask when he came to Fidelity?

Q. Yes.

A. Around January, 1938. Prior to that time he was in Baltimore,

Q. Working for Fidelity?

A. That is right.

Q. Do you know how long he had been with Fidelity in all?

A. You mean the total of the years?

Q. Yes.

A. I would say seven or eight years.

Q. And in 1938 he came down to Wheeling?

A. That is right.

[fol. 968] Q. And what was his position at that time?

A. Vice President.

Q. What had his position been in Baltimore, if you know?
A. He was manager of the Baltimore district.
Q. That is, for sales?
A. Yes, for sales.
Q. Had he taken an active part, himself, in making sales of contracts?
A. In selling; yes, I understood he had. Of course, I don't have any way of knowing, I was not over there, but I understood he sold contracts and also trained men to go out and solicit business.
Q. What were Mr. John Marshall's duties when he came down to Wheeling as vice president?
A. Well, he had several duties. He had charge of purchasing. He answered correspondence and he interviewed clients of Fidelity—several duties.
Q. Do you know what his experience was previous to that time in that sort of work?
A. Well, in the selling business you have a lot of experience, I would say, in getting the human slant on things. He was very well equipped, when he came to Fidelity.
[fols. 969-974] Q. Would you say that that kind of experience would qualify you in purchasing supplies for the company?
A. Well, that was not his only duty.
Q. But that was one of them.
A. That is right. He was very good.

. . . . . .

[fol. 975] WALTER J. GRIBBEN, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name to the Court, please.
A. Walter J. Gribben.
Q. Where do you live?
A. Wheeling, West Virginia.
Q. What is your occupation?
A. Auditor of Fidelity.
Q. How long have you been auditor of Fidelity?
A. Approximately fourteen years.

Q. As such auditor, explain to the Court briefly what [fols. 976-991] your duties were.

A. Well, my duties have been mainly the details of the general records and the handling of the insurance phase of the Series B Contract, also much of the duties of Fidel.

Q. Now, particularly since 1937, are you acquainted with the fact that Fidelity had a number of unusual or extraordinary expenses over and above those incurred in the usual course of business; for instance, attorneys' fees and actuarial fees and auditors' fees, and any other fees?

A. Yes, sir.

Q. Explain those to the Court, if you will, Mr. Gribben.

A. Well, particularly since 1938, with the number of attorneys that have done work for the association, there has been rather an unusually heavy attorney fee; and, in addition to that it was necessary to have auditors come in and examine the books and records of the association, which resulted in rather heavy auditing fees, also.

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[fols. 992-1100] Q. Now, Mr. Gribben, I am going to ask you to prepare for me from the books of Fidelity, for introduction in this case, all of the attorneys' fees spent by the company during the last twenty years, including those of Mr. Marshall when he was your attorney, and any one else, as well as the expenses which were paid for Mr. Marshall, or any one else, for their offices as part of their rent, as stenographic fees and so on, for the last twenty years. Can you prepare that from the books of the company?

A. I believe so.

The Court: How long back?

Mr. Palmer: Twenty years, your Honor.

The Court: That is going back too far, I think.

Mr. Palmer: All right; say the last fifteen years.

The Court: No, I think ten years would give a fair impression of what the average would be.

Mr. Palmer: All right, sir.

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[fols. 1101-1125] H. Isaiah Smith, recalled as a witness by the debtor, testified as follows:

• • • • • • •

[fol. 1126] Q. Did you give us the liabilities of the general fund, Mr. Smith? You gave us the total assets. Did you give us the total liabilities?

A. The balance sheet shows a deficit in the net worth of the capital stock of $1,391,230.15.

Q. You say of the capital stock?

A. That is right.

Q. Do you mean by that——

A. Capital and preferred stock.

[fol. 1127] Q. The general fund is at least $1,391,000 in the hole—I say, at least that?

A. Yes.

Q. And by what you have given us before with reference to other valuations, it would be approximately at least two million dollars in the hole?

A. Let me correct my statement on $1,391,000. It wouldn't be that high, because that includes a reserve of $750,000 to secure the note of National Sales Agency.

Q. That note is not worth more than the paper it is written on, is it?

A. No, I say it has been transferred. It increased this $1,391,000 by transferring it as a reserve against this note. That is a liability: they are not holding it as an asset. If you wipe that reserve out, then your deficit in the general fund would only be $640,000.

Q. And you need that reserve, because we know the note is not worth anything.

A. I know the reserve is good.

Q. And you know that there is at least another half million dollars, I think you told us, between book value and actual value in the assets which is not reflected in that [fol. 1128] deficit figure you have given us? Isn't that correct?

A. That is right.

Q. And there is probably a further deficit as shown by the real estate, is there not, in your opinion?

A. No, because the real estate has been mortgaged to the various contract funds. Of course, there would be a deficiency there; if the contract funds would foreclose, they would probably come back with a deficiency on the general fund.

Q. And the amount to which it is mortgaged to the contract funds, can you say, in your opinion, whether or not they would realize that much from them?

A. I doubt if they would.

Q. So, in other words, there is shown roughly at least two million dollars of deficit in the general fund—I say, roughly, taking everything?

A. No, it wouldn't be that high. I corrected this figure here to the extent of three-quarters of a million dollars. It couldn't be two million dollars, because the book value of the assets is $2,311,000.

Q. Will you give me a fair approximation of what you believe the deficit is?

[fol. 1129] A. It is my opinion—I am saying this is roughly—but it is my opinion that the assets in the general fund would be worth in the neighborhood of a million dollars against a liability of $2,311,000.

Q. From your work with the Fidelity Company, have you ascertained, or has the trustee ascertained or the West Virginia State Court receivers ascertained the exact amount of money that each contract holder had coming due him as of a given date by virtue of his contract?

A. That is in the exhibit of our creditors filed at the August 5th hearing.

Q. That has been worked out as of what date?

A. As of June 6th. However, the reserves, I believe we qualified our statement when it was filed by saying that there had been no improvement in the reserves since April 10th 1941.

Q. Mr. Smith, you also know, do you not, all of the assets of the company applicable to those liabilities? Is that correct?

A. That is right.

Q. And you also know the assets of each fund as shown by the books of the company applicable to the liabilities of each series fund? Isn't that true?

[fol. 1130] A. That is right.

Q. And you have also broken it down, have you not, so that there are shown the liabilities to the contract holders of each State, and the funds deposited in that State applicable to those liabilities?

A. I think that has been introduced in testimony.

Q. Mr. Smith, you were and are one of the West Virginia State Court receivers, is that correct?

A. That is right.

Q. The other receiver, whom I note to be absent from the hearing at the time this question is asked you, is Mr. Ross B. Thomas? Is that correct?

A. That is right.

Q. Will you give the Court an idea of the capability of Mr. Thomas to serve with you as a receiver in the State Court?

Mr. Fleming: To this the debtor objects.

The Court: What is the pertinency of that, Mr. Palmer?

Mr. Palmer: Your Honor, whether there was a prior proceeding pending under Section 4, I believe, of the Bankruptcy Act—146, Section 4—so that the Court would have an idea in arriving at its opinion as to whether or not [fol. 1131] those who were handling it in the State of West Virginia are capable—capable in a small degree or a greater degree—of carrying on a reorganization proceeding. I think the Court wants to inquire into that matter—and the coreceiver would probably be the best one to——

The Court: Let me see that section a moment and see what it does say.

(Mr. Reinhardt hands pamphlet to Court.)

Mr. Palmer: 146.

The Court: I will overrule the objection.

Mr. Palmer: Do you have the question in mind, Mr. Smith?

The Witness: Will you read the question?

(The question was read.)

A. I found Mr. Thomas very helpful. We more or less divided our work, in that the financial end, I looked after it, and he advised with me on the legal aspects, and since he had worked considerably with the company in previous years in preparing the statement for registration with the Securities and Exchange Commission, he was very familiar with the affairs of the company; it made him quite helpful to me. Now, as to what I was to him, I don't want to say.

Mr. Palmer: I am not going to ask you about yourself, [fol. 1132] Mr. Smith, but did Mr. Thomas, at the time of

the appointment and throughout your work, have in mind the entire legal setup of Fidelity, would you say?

A. He seemed to have, yes.

Q. And did he have in mind or learn of the various liabilities to the contract holders?

A. Yes, we would go over those statements together.

Q. Had you prepared, as West Virginia State Court receivers, the liabilities of the company to each contract holder as of April 10th before you were relieved of your duties?

A. We had not prepared a list similar to that submitted by the trustee for the August 5th hearing—that is, the contract holder's name and address and his liability—but we had prepared statements of the total liabilities by funds.

Q. By States?

A. By States, yes.

Q. And were you collecting the assets of the company in West Virginia? Had you already collected them at the time you were relieved on June 6th?

A. We had in our possession all the assets in the State, [fol. 1133] except the assets on deposit with the State Treasurer of West Virginia.

Q. Had you been in correspondence with and in touch with the various other State commissions and State insurance commissioners or State depositories and their attorneys where ancillary proceedings were going on?

A. We had general correspondence with most of them, I would say.

Q. And they were corresponding with you and you with them, is that correct?

A. Yes. A number of times they had asked us for a list of contract holders for their States and so forth, and we were in correspondence in that respect more than anything else, I would say.

Q. Were you furnishing what they required or asked of you?

A. We had not furnished a list of contract holders by States.

Q. You were preparing or prepared to do that if the need arose therefor?

Mr. Fleming: This has all been covered, your Honor, in the previous examination in rather close detail, is my [fol. 1134] recollection.

The Court: I don't remember that it has been. I think Mr. Palmer has a purpose in this, to show, if he can, that under Subsection 4, Section 146 of Chapter 10, there was a prior proceeding pending in which the interests of all parties would be best subserved. That is the purpose, I take it?

Mr. Palmer: That is right.

The Court: And for that purpose I will permit this witness to answer such questions as he can answer.

A. Of course, we would have prepared the list. We felt, however, that before doing it, the Circuit Court should authorize making the expenditure and the cost of the preparation of the list.

Mr. Palmer: Isn't it true that you were from time to time filing your reports with the Circuit Court of Kanawha County as to the progress of your work?

A. That is right.

Q. And I believe one report of more than fifty pages concerning your work was prepared and filed? Is that correct?

A. That is right.

Q. And were you conferring with both Auditor Sims and [fol. 1135] Judge Bouchelle of the Circuit Court during your work?

A. Oh, yes.

Q. You didn't attempt to take into your possession any of the assets of the other State depositories? Am I correct in that?

A. We attempted to get some cash that was on deposit—small amounts—corral the cash under the Court's jurisdiction, but did not succeed in all cases. We didn't get any securities nor attempt to get any securities from any of the States.

Q. Isn't it a fact, Mr. Smith, that you and Mr. Thomas did act as fully with regard to Fidelity as you have been permitted to do so far in the present case?

The Court: I didn't understand that.

Mr. Palmer: In this, your Honor, that Mr. Smith, as I understand, is an employee of the trustee, and that under the West Virginia receivership they acted as fully with regard to the affairs of Fidelity as the trustee has so far acted or been empowered to act in this present proceeding.

with the exception of the injunctive part of the Court's order.

Mr. Fleming: The debtor will object.

[fol. 1136] The Court: In that question you lose sight of the fact that the matter of the Court's jurisdiction is still pending, and that while that is pending, the trustee is not pursuing the activities that would be pursued if it were determined that the Court had jurisdiction.

Mr. Palmer: That was the purpose of my question. I tried to phrase it to show that up to the present time, under the Court's authorization, that the West Virginia State Court receivership acted as fully as has the trustee been permitted by the Court up to the present time.

Mr. Fleming: It calls for a comparison, your Honor, which I don't think is proper.

Mr. Palmer: I am asking him as a question of fact, not a question of opinion or law.

The Court: I sustain the objection to that question on the grounds I have just indicated.

Mr. Palmer: I would like to make proof of the question and ask the witness to answer so I can vouch the record by his answer. Can you answer, Mr. Smith?

A. Of course, the trustee is not acting, or is unable to get securities into their hands, not because we would not like to, or the trustee would not like to, but the Court has [fol. 1137] frozen those securities in a way that the trustee can't get them.

Q. My question is, Mr. Smith, of which I want to make proof on the record, isn't it a fact that you and Mr. Thomas, as West Virginia State Court receivers, acted as fully and as in great detail in your work as such receivers as has the trustee under the present rulings of the Court?

Mr. Fleming: That is the question I objected to.

The Court: I sustain the objection, but he is offering this on the record, which I will permit him to do.

A. I would say we were, in view of the fact that the trustee is being restricted, under the Court order, from operating——

Mr. Palmer: The point I want to bring out—this is still on proof—is that up to the present time the West Virginia State Court receivers were able to act as fully about Fidel-

ity's matters as has the trustee under the rulings of the Court up to the present?

Mr. Fleming: I submit that the witness has answered this question and is being pressed, apparently, for another answer.

Mr. Palmer: I am making proof under the Court's ruling [fol. 1138] as to which he sustained the objection.

The Court: I have sustained all the objections.

Mr. Palmer: Will you read the question.

(The question was read.)

A. Yes.

Q. If you had been permitted to go on as West Virginia State Court receivers, Mr. Smith, were you and Mr. Thomas prepared to carry on your duties fully as permitted you by the laws of the State of West Virginia and the instructions of the Auditor and under the direction of the Circuit Court of Kanawha County?

A. I think so.

Q. I am not certain as to whether this next question has been covered or not. Isn't it a fact that, other than the one contract holder, who asked that he be notified before any plan was approved, that there was no other objection filed in the Circuit Court of Kanawha County to the proceedings therein pending?

Mr. Fleming: The debtor objects to that. The very same question was asked.

The Court: That has already been asked and answered.

Mr. Palmer: Then withdraw it, please. I wasn't certain [fol. 1139] of that, and I do not want to encumber the record.

The Court: Mr. Price, let the record show that the Court changes its ruling as to the admissibility of the testimony as to how the State receivers conducted the business in comparison with how the trustee has conducted the business and permits that to go in, overruling the objection.

Mr. Palmer: And the offer of proof can now stand as the testimony without giving it again?

The Court: Yes.

Mr. Palmer: Mr. Smith, on page 25 of your answer, you set up that, "The various States in which the debtor has engaged in business provide a complete and adequate means of liquidation of insolvent companies such as the debtor by

Courts of competent jurisdiction, and that upon disinissal of the proceedings herein, if no reorganization can be effected, the State Courts could locate the assets of the debtor within their respective jurisdictions and distribute the sum of money to those creditors entitled thereto, without the necessity of incurring the unnecessary expense and delay and multiplication of plenary suits and so forth." Can you state whether or not you and Mr. Thomas, had it been found that reorganization was impossible, as State [fols. 1140-1149] Court receivers, together with Mr. Sims, were prepared to carry on the duties of liquidation under the statutes of West Virginia?

Mr. Fleming: To this the debtor objects. That has been answered.

The Court: I am not sure. I will overrule the objection.

A. Yes, I think so.

Mr. Palmer: Waiving aside your natural modesty for the moment, do you think that you and Mr. Thomas were capable of performing your duties?

A. I think so.

* * * * * * *

[fol. 1150] Q. Mr. Smith, I believe you and Mr. Thomas were State Court receivers. What is Mr. Thomas' first name?

A. Ross.

Q. Ross Thomas?

A. That is right.

Q. And with what law firm has he been connected for some time?

A. The law firm of Koontz & Koontz in Charleston.

Q. And was he connected with that firm at the time he was appointed receiver of Fidelity?

A. Yes.

Q. And did he continue as a member of that firm after [fol. 1151] his appointment as receiver?

A. I don't know his relationship with the firm. I know that he devoted practically all of his time to the work of the receivership, either here or preparing reports for the receivers here in Charleston.

Q. But he worked out of Koontz & Koontz' office, as I understand?

A. Yes, sir.

Q. I assume that after you were appointed receivers, you petitioned for the employment of Koontz & Koontz as attorney for the receivers?

A. That is right.

Q. And they were named by the Court as attorneys for the receivers?

A. That is right.

Q. Did you know at that time that the Koontz firm had been attorneys for Fidelity for several years?

A. No, I didn't know it.

Q. Did you know at that time that they had received fees approximating, say, ninety-two or ninety-three thousand dollars for the three years prior to the time they were employed by you and Mr. Thomas as attorneys for your-[fols. 1152-1153] selves as receivers for Fidelity in the State Court?

A. No, I didn't know that.

Q. You know it now, do you not?

A. It has been developed during this hearing.

Q. And they are still representing the receivership, aren't they?

A. That is right.

Mr. Palmer: If your Honor please, I move to strike those last questions as being irrelevant to the subject under discussion.

Mr. Fleming: I think they are highly important, your Honor.

The Court: It seems to me, Mr. Palmer, that that is proper cross-examination on the matter that you brought out, as to whether there is a proceeding pending in which the interests of all parties will be best subserved, and you asked the questions.

Mr. Palmer: I think the Court is probably right in that. I withdraw the objection.

* * * * * * *

[fols. 1154-1161] The Court: Before you go into that, there is one other question I want to ask about Mr. Thomas and his connection with this company. I understand from your answer, Mr. Thomas had a great deal of familiarity with the affairs of the company. I would like to find out, if you know, what led to his familiarity with its affairs.

A. I think Mr. Thomas did a good deal of work with reference to the preparation of the statement that was filed

with the Securities and Exchange Commission, looking towards registering the company.

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[fol. 1162] Q. Mr. Smith, did you ever see the large printed or typewritten report prepared by Mr. Ross Thomas for filing with the Securities and Exchange Commission?

A. Yes.

Q. And about what size book or volume is it?

A. Oh, it is a large volume—let's see. To give the dimensions from memory, I would say it was—oh, it was about ten by twenty inches. That is a guess, ~~and about~~ possibly two and a half or three inches thick.

Q. Containing approximately how many pages?

A. I wouldn't know, Mr. Palmer. I have seen the report.

Q. Was that report printed or typewritten?

A. Printed.

Q. Did that printed report contain practically all of the activities of Fidelity which you and he could use as a basis or guide for your work as State Court receivers?

A. Yes. It was very helpful to us; it covered the details.

Q. And did the compilation of that report indicate a very [fols. 1163-1167] deep research into the financial and other workings of the Fidelity Company?

A. It did.

Q. From seeing that report and knowing of its preparation by Mr. Thomas, did you come to the conclusion that he was thoroughly familiar with all the details and ramifications of the Fidelity Company?

A. I did.

• • • • • • •

[fol. 1168] Q. During the period April 10th to June 6th, 1941, did the value of the assets in Charleston ever drop below $9,992,985.79, which is the figure shown on your schedule of assets as of April 10th, 1941?

A. No, we made no withdrawals of securities.

Q. The coupons that you, as receiver, clipped during the interim between April 10th 1941 and June 6th 1941, did they include coupons appertaining to securities that were on deposit with the State treasurer of the State of West Virginia.

A. That is right.

Q. Did they include any other securities?

A. I don't recall whether or not we cut any coupons during that period from free securities that were held in our vaults or not. If we did, it would be a small amount.

[fol. 1169] The Court:

Q. Mr. Smith, do you know who had been cutting the coupons from those securities since the time in May that the receivers took over?

A. To my knowledge, Your Honor, there had been no coupons cut since that date on the West Virginia deposit.

Q. Have there been maturing coupons from time to time since then?

A. Oh, yes. The June 1 maturity would be a fairly good sized maturity, and July 1 is one of the largest maturity dates we have for interest coupons.

Mr. Palmer: I didn't hear the Court's question.

The Court: I want to know who has been clipping those coupons on the securities that are in West Virginia. He said nobody.

Mr. T. C. Townsend: Since June 6th.

Mr. Palmer: In relation to that I got in touch with the trustee personally at the request of the Auditor to ask if the trustee could furnish someone to aid the Auditor in doing that. There was no one employed by the Auditor or the State Treasurer whose services could be spared for that. The trustee said they couldn't spare anyone to help do that, and they didn't feel that they should; so that is one of the [fol. 1170] reasons why it has not been done. The trustee said they did not feel that they could spare any one of their employees to aid in that work.

The Court: Mr. Townsend, do you know anything about that, as to the clipping of the coupons?

Mr. T. C. Townsend: Yes sir, we know something about it, and I would like for the trustee to make his own statement, if the Court will permit it, about the efforts he has made to have the coupons clipped.

The Court: I would like to have that done.

Mr. T. C. Townsend: Go ahead, Mr. Dickinson.

Mr. John L. Dickinson: We notified the Auditor, and sent a copy to the Treasurer, of the coupons that were due as well as the bonds that were due and unpaid. As I recall it, the Treasurer advised us that he had nobody in his office

who could cut them, and wanted us to do it. We didn't object particularly to doing it, and would have done it, but they had the securities locked up jointly with us and we didn't have the privilege of going into the vault to get them without them, and they have steadfastly refused to do anything further. There is now, I think, a question up, if the bonds that are matured and the coupons that are matured [fol. 1171] are collectible, as to whether that particular fund would go to the Treasurer or the Auditor of the State, whoever should get the bonds, free of any connection with the trustee, our position being that inasmuch as this box was held by Fidelity and then the trustee—Fidelity jointly with the State—certainly the trustee then superseded Fidelity and likewise had that same right as to whether or not the funds derived should be held jointly by the two. That has occurred quite recently, so recently that neither the trustee nor the counsel for the trustee have had the opportunity to discuss with the Court just what we should do. We are entirely willing to furnish a man to help them cut the coupons. I think we are just about as busy as they are. We didn't want to go down ourselves and cut the coupons.

The Court: Well, the coupons ought to be cut, it seems to me, and then the cash derived from the coupons ought to be put in the same status as the securities themselves. Later it can be determined what to do with it.

Mr. Dickinson: The difficulty, Your Honor, is when those coupons are cut or the bonds mature, when they are turned over to whoever collects them that is immediate cash, and so regarded, and then the question of where the funds go [fol. 1172] arises, and whether it should be held by the trustee jointly with the State, or whether it should be turned over to the State.

The Court: Is there any reason why the cash should not be put in the vault?

Mr. Dickinson: Held jointly by the two?

The Court: Yes.

Mr. Dickinson: We have made that suggestion, but I think we have not had a reply. I have been out of the city for a few days and am not right up to date on it.

The Court: What would be the objection, Mr. Palmer, to cutting the coupons and collecting on them and then having the proceeds in the same status that the securities now have?

Mr. Palmer: I can't see any, Your Honor. I talked to Mr. Dickinson personally on the phone some little time ago at Mr. Sims' request and asked that some one of the trustee's force be authorized to aid Mr. Sims in the clipping, and Mr. Dickinson at that time informed me that the trustee didn't have a person that they could spare and didn't feel they should; it was up to Mr. Sims.

The Court: You two get together on that and get these [fol. 1173] coupons clipped.

Mr. Dickinson: There is no trouble about getting together. I think you are mistaken, Mr. Palmer: I think you talked with Mr. Payne. If you say you talked to me, I will accept your statement.

Mr. Palmer: I wouldn't want to be sure either.

Mr. Dickinson: The substance was that the treasurer wanted somebody to cut all of his coupons, without him helping at all, as he was very short of men. We were very short at the time ourselves.

Mr. Palmer: I can't see, unless Mr. Sims can, why they can't be clipped and the cash put right in the vault in the place of the coupons.

Mr. Edgar B. Sims: I have already authorized the Treasurer, Mr. Talbot, to clip the coupons and obtain the cash and to retain the custody of the cash for the use and benefit of the contract holders. Likewise I have instructed him to sell certain bonds that have been called and take the cash and retain possession of it for the use and benefit of the contract holders.

The Court: Well, what you mean by that is just to leave it at the same place that the securities are, don't you?

[fol. 1174] Mr. Sims: I believe under the law I can tell the Treasurer now he shall keep it. I told him to retain it.

The Court: All right. Anyhow, somebody get those coupons cashed.

* * * * * * * *

[fol. 1175] Q. In other words, the highest that the assets ever were between April 10th and June 6th, 1941 was this $23,000,000 figure that appears on your schedule as of June 6th?

A. I would be safe in saying that that would be the highest figure.

Q. You have testified with respect to the West Virginia state receivership. Who were the people who would be the

beneficiaries of that receivership? Who had an interest in the proceedings? Was it just the West Virginia contract holders, or was it others?

A. Well, of course, the notion was that as state court receivers we would attempt to reorganize or manage the assets of the company in a way that would be beneficial to all the contract holders everywhere.

Q. Whether they were West Virginia residents or residents of other states?

A. Well, that would have been our intention, yes.

Q. Do you know anything about the rights of contract holders in or outside of West Virginia with respect to sharing in the West Virginia deposit?

A. Yes, I know that in states where deposits were not [fol. 1176] maintained or were maintained in an amount less than the liabilities for that state, that those securities were on deposit with the State Treasurer of West Virginia. Did I answer your question? Maybe I didn't.

Q. Out of the twenty-nine states which contained people who held contracts of this debtor, in how many of those states, if you know, were the deposits sufficient to satisfy the total cash liabilities?

A. I could refer to the records. Off hand, I do know that Wisconsin was fully covered. I say by that that the value of their assets equalled the liabilities to contract holders. And the State of Iowa—I can't answer that, Mr. Reinhardt from memory. I can refer to the—but there is no more than two or three states wherein the deposits were equal to the amount of liabilities.

Q. Would it be fair to say that in at least twenty-five of the twenty-nine states there were either no deposits or a deficiency of deposits?

A. I think that would be a safe statement.

Q. And according to your understanding, contract holders in each of those twenty-five states would be entitled to look to the West Virginia deposits for satisfaction in all of [fol. 1177] their obligations?

A. That is my understanding.

Q. Mr. Smith, you testified as to a deficiency in the general fund. Does that reflect the fact that the total assets of this debtor were of a value less than its total cash liabilies?

A. No, my statement with regard—I was treating the general fund separately. I wasn't trying to group the over

all assets and liabilities of the company, including the contract funds.

Q. Will you address yourself to that other question that you didn't cover before and indicate whether on the basis of your knowledge you can say that the liabilities of this debtor, the cash liabilities, exceeded the market value of its assets on June 6th, 1941?

A. You mean as a whole now, the contract funds—the total of the contract funds and the general fund? The liabilities were greater than the market value of the assets on June 6th.

[fol. 1178] J. H. SCHELLHASE, recalled as a witness on behalf of the debtor, testified as follows:

Direct examination.

By Mr. Fleming:

Q. You may state your name to the Court, please.

A. Harold Schellhase.

Q. You are the same Mr. Schellhase who has testified heretofore in this case, are you?

A. I am.

Q. You have been employed by Fidelity for some period of time, have you?

A. Yes sir.

Q. For how long?

A. Approximately sixteen years.

Q. What is your present position?

A. Statistician.

Q. How long have you been so employed?

A. As statistician about a year and a half.

Q. What did you do prior to that?

A. I worked on the accounting, making statements.

Q. That is, for the past seventeen years the greater por-
[fol. 1179] tion of the time you have been in the accounting department?

A. Yes.

Q. And as statistician you are still in that same department, aren't you?

A. I have access to the accounting department.

Q. When you first came with Fidelity these income contracts were being sold by Fidelity, at that time, weren't they?

A. The annuity contracts?

Q. The annuity contracts.

A. Yes sir.

Q. Was there a contract preceding that, a special income contract?

A. Special income.

Q. That came before the annuity contract?

A. Yes sir.

Q. As these contracts were sold, and as the funds derived from the sale of these contracts came into the company, when you first came in how were those funds handled from an accounting and bookkeeping viewpoint?

A. Of course, at that time, when I came into Fidelity [fol. 1180] I came in as a messenger.

Q. You did?

A. Yes, sir. But it is my recollection that the income fund was kept separately from the annuity fund.

Q. Then later the Class A contract was created, wasn't it?

A. Yes, sir.

Q. And then later Class B contract fund was created?

A. Yes.

Q. Then later Class C and D were created?

A. Yes, sir.

Q. While you were with the company were those contract funds kept separate as a bookkeeping transaction?

A. Yes, sir.

Q. On the books of the company?

A. Yes, sir.

Q. When securities were purchased by the use of those funds—that is, from those funds—how would those securities be handled from a bookkeeping viewpoint?

A. Well, they would be purchased for the fund from whence the money came.

Q. Did you have a complete record of all monies re- [fol. 1181] ceived by the company from each contract fund and a record of all securities purchased by the company from the monies from each contract fund?

A. Each security was earmarked for what fund it was purchased for.

Q. Did you have a description of each security that was purchased?

A. Oh, yes.

Q. And that was allocated at the time it was purchased to the particular contract fund?

A. That is right, yes, sir.

Q. As securities were deposited in the various states with the state officials under the state laws, did you have a record of what fund those securities belonged to?

A. We always had a record of what fund——

Q. And, for instance, in Wisconsin you know how many securities they have that belong to the special income fund?

A. Oh, yes.

Q. The special annuity fund?

A. Yes.

Q. The Class A contract fund?

A. Yes.

[fol. 1182] Q. The Class B contract fund?

A. Yes, sir.

Q. The Class C?

A. Yes.

Q. And the Class D?

A. Yes.

Q. Have you made a compilation for the purpose of showing from the records of the company the status in each state of the securities on deposit in that state and particularly in reference to what contract fund those securities belonged to?

A. We have such a record.

Q. You have?

A. Yes.

Q. Do you have a memorandum of the compilation with you?

A. On some particular states.

Q. What states have you?

A. One for Illinois, Maryland, Missouri, Ohio, Tennessee and Wisconsin.

Q. Could you make that compilation for all of the states in which securities are deposited?

[fol. 1183] A. Yes, we could. That was prepared jointly by Mr. C. E. Smith and myself.

Debtor's Exhibits 50 to 55, inclusive, Six papers which were produced by the witness were marked for identification, at the request of Mr. Fleming, as above indicated.

Q. I hand you debtor's Exhibit 50, which you may examine and tell the Court, if you will, what that is.

A. It is a statement of the State of Illinois on securities held—market values of securities held June 6th 1941 as

against net cash liability as of April 10th, 1941 by contract funds.

Q. Will you just explain to the Court, if you will, in reference to those contract funds, what they show in the State of Illinois at the time that compilation was made?

A. You mean read these?

Q. Yes.

A. The income fund has no securities on deposit, with a cash liability of $160,707.29. The annuity fund has securities on deposit of $254,633.75, with a net cash liability of $645,388.18. Annuity maturity and retirement fund, securities $257,413.75, with a net cash liability of $533,232.16. [fol. 1184] The Series A fund, securities, $505,316.50, and net cash liability of $533,110.28. Series A Maturity and Retirement Fund has no securities on deposit but has a cash liability of $20,227.79. The Series B fund has securities on deposit of $2,488,515.00, with a net cash liability of $2,096,356.29. The Series B Maturity and Retirement Fund has securities of $254,015.00 with net cash liability of $231,072.15. The Series C fund has no securities and no liabilities. The Series D fund has no securities, with a liability of $5,696.61. The Series D maturity and Retirement Fund has no securities and no liabilities. The general fund has no securities and no liabilities. The total securities equal $3,759,894.00, and total net cash liability is $4,225,790.75.

Q. I hand you debtor's Exhibit 51, which you may examine and state to the Court what that represents?

A. It represents the securities on deposit and the net cash liability for the State of Maryland.

Q. And that was made upon the same basis as you made it for the State of Illinois?

A. That is right.

Q. I now hand you debtor's Exhibit 52, which you may [fols. 1185-1195] explain to the Court, if you will, please.

A. That is the State of Missouri securities on deposit and net cash liability.

Q. On the same basis as Illinois?

A. Yes, sir.

Q. I now hand you debtor's Exhibit 53, which you may explain to the Court.

A. For the State of Ohio, securities on deposit and net cash liability.

Q. I now hand you debtor's Exhibit 54, which you may examine and explain to the Court, if you will.

A. The State of Tennessee, securities on deposit and net cash liability, the same as Illinois.

Q. I also hand you debtor's Exhibit 55, which you may examine and explain to the Court, if you will, please.

A. State of Wisconsin, securities on deposit and net cash liability, the same as Illinois.

Mr. Fleming: Would you like to examine these? I will make my offer and then you can examine them. Debtor now offers to introduce and read in evidence debtor's Exhibits 50 to 55, both inclusive.

. . . . . .

[fol. 1196] By Mr. Huwe:

Q. You were on the stand and testified for a short time at the last session, weren't you? At that time, if you will recall, you stated that the cash payments that came into the various contracts, especially special income, special annuity, Series A and the cash of the general fund was carried as one cash account in the bank?

A. Prior to 1938.

Q. Prior to 1938?

A. Around that time.

[fol. 1197] Q. And you discontinued that practice after the injunction of 1938?

A. Yes, sir.

Q. What was your practice prior to 1938 with reference to B, C and D contracts?

A. They had a separate bank account.

Q. So that the cash payments from the contract holders in those three accounts always were kept separately in the bank, as well as everywhere else?

A. That is right.

Q. With respect to all of those different series of contracts after 1938, after the injunction, and during '39 and '40——

A. They each had separate bank accounts.

Q. Each had separate cash accounts?

A. Yes.

Q. So that there was at no time any commingling of cash of one fund with that of another after December, 1938?

A. That is correct.

The Court: What do you refer to when you say "after the injunction"?

Mr. Huwe: By "injunction" I presume we both mean the [fols. 1198-1211] injunction proceedings in the eastern district of Michigan at Detroit, brought by the SEC in December, 1938.

. . . . . .

[fol. 1212] By Mr. Reinhardt:

Q. Mr. Schellhase, are you familiar with the bookkeeping that occurred when a contract in a particular state matured and was paid off? I say, are you familiar with the bookkeeping that occurred at that time and in that connection?

A. I know what happens.

Q. Will you describe briefly what happens on the company's books when a contract matures and is paid off in a state in which the company has a deposit?

A. Well, of course, the company pays out of cash.

Q. Will you take a particular contract in a particular series and tell us what cash they use, where the cash comes from and so on.

[fol. 1213] A. Of course, a contract of the Series B or Series A fund at the time the last payment on the contract is transferred to the maturity and retirement fund by cash; and, of course, that cash is invested the same as the regular contract fund for the payments that are coming in on it. Then when a contract matures, of course, there is usually cash on hand to take care of maturity or to pay out the amount of the maturity settlement.

Q. That cash would be in a bank account belonging to that particular fund?

A. That is right since 1938.

Q. The cash would be withdrawn from the bank account belonging to the fund allocable to that series of contracts?

A. That is right.

Q. And would be withdrawn from that account and paid to the contract holder?

A. That is right.

Q. Now, how would that be reflected in the deposit made in the contract holder's state?

A. Of course, the liability after the contract has matured and went out—the liability, of course, was not there; the state would be reduced by that much.

[fol. 1214] The Court: The liability would, but what about the security?

Mr. Reinhardt:

Q. What about the deposited security?

A. Well, of course, for one particular contract there probably would not be anything done about it. Of course, if the liability decreased so much so that you would have a big deposit up there with no liability, we would ask to have some of it withdrawn.

Q. Did that ever occur?

A. Well, I think in 1939 it did occur, when the surrenders were very heavy there in the first part of '39. I am not so familiar with that. The securities department can answer that better than I on the withdrawal of the securities, whether we actually did withdraw it.

Q. Suppose a contract matured but the money was not paid out immediately. Suppose that contract holder elected to receive installment payments. How would that be reflected in the treatment of the securities on deposit in the contract holder's state?

A. It would have the same effect as paying the full amount due. What I mean by that is that you would always reflect the decreasing liability for that particular contract.

[fol. 1215] Q. You would reflect it only to the extent that cash payments actually were made out?

A. That is right.

Q. And it was not until the liability on that series of contracts in that particular state was substantially below the deposited amount that a request would be made by the company for the withdrawal of deposited securities?

A. Well, I don't know—the only time that I recall—and I am not certain about it—is that the only time we requested the states to take down some of those securities was in 1939. Most of the time I would say those securities were held out there for the increasing number of payments probably of some other contract fund, so that the deposit was maintained at all times either by that particular contract fund or by another fund's securities.

The Court: Let me ask you this. There were a number of funds shown on your own book, but your deposit in the state was just one deposit, wasn't it, and not separated into funds?

A. I think that is—I don't know for sure about that, but [fol. 1216] I think it was just one deposit in a state.

Q. Then, even if one fund did accumulate a surplus in a state, if some other fund was short, you couldn't get back any money from the fund that had a surplus, could you?

A. No, unless we would put up securities of the same value in the fund that was short.

The Court: Go ahead.

Mr. Reinhardt:

Q. Are you personally familiar with the deposit and withdrawal of securities in the state depositories?

A. I am not.

Mr. Reinhardt: Then I won't continue this examination. Who is?

A. I would say Mr. C. E. Smith and Mr. Hubert Young.

Q. In response to one of these later questions, you said that a security that was on deposit with a state that had originally been deposited to secure a particular contract in a particular series would remain when that contract matured and might remain to secure a contract of another series. Did you mean that, or do you mean that it might remain to secure a contract of that same series, but not [fol. 1217] the same contract?

A. Well, it may mean both ways. It could be there to secure the contract of the same series or of another series, if the deposit is needed.

The Court: It depends on which one was short, doesn't it?

A. Yes.

Mr. Reinhardt:

Q. Do you know of your knowledge whether either or both of those situations actually did occur?

A. I would say that probably both of them have occurred.

Q. Your answer would apply to cash surrenders as well as to maturities of contracts?

A. That is correct.

C. E. SMITH, called as a witness on behalf of the debtor, having been duly sworn, testified as follows:

[fol. 1218] Direct examination.

By Mr. Fleming:

Q. State your name to the Court, please, Mr. Smith.
A. C. E. Smith.
Q. Where do you live?
A. Brookside, Bridgeport, Ohio.
Q. Is that near Wheeling?
A. About two miles from Wheeling, yes.
Q. Have you been employed with Fidelity for some time?
A. Since July 1st, 1917.
Q. You have been with Fidelity ever since?
A. Yes.
Q. Still with them?
A. Yes.
Q. What was the character of your original employment with Fidelity?
A. Started as a messenger and addressograph operator.
Q. What have you been in recent years?
A. Assistant secretary.
Q. What other capacity?
A. For a short time in 1940 up to, I believe, March of this year I was a director.

[fol. 1219] Mr. Palmer: Will you speak just a little louder, please?

The Witness: I say for a part of 1940 and I believe up till March of 1941, at the annual meeting, I was a director.

Mr. Fleming:

Q. What have been your duties in recent years, Mr. Smith?
A. In recent years I have been in charge of the security records, that is, the recording of the security transactions as to the commitments that have been filled.
Q. And in that capacity did you have to do with the handling of securities of Fidelity?
A. Not the physical handling of securities to any great extent. That was limited to such securities as may be in our own vaults at Wheeling and such securities as might be sent down from New York to Charleston or shipped from Charleston to New York.

Q. Did you have anything to do with the handling or procuring of the income from the security portfolio of Fidelity?

A. Yes, that was part of my duties to take care of the collection of the income.

[fol. 1220] Q. Who received the income from the security portfolio while you were working for Fidelity?

A. The major portion of it was sent to us at Wheeling by registered mail coming from the various depositories.

Q. That is in the various states?

A. Yes, and those securities which were in New York in our own—I should say in banks acting as our safe keeping agents, they would usually cut the coupons, collect them, and credit our account with the proceeds, which were then duly credited upon our records upon the advice of the collecting bank.

Q. How was that handled here in Charleston and West Virginia?

A. In Charleston the State Treasurer's deputies would clip the coupons from securities on deposit with the state and deliver them to me and I, in turn, would mail them to Wheeling, and from that point they would go through our records as deposited in a bank.

Q. That is, you would come to Charleston?

Mr. Palmer: If Your Honor please, I can't hear either the witness or Mr. Fleming. I am sorry. I think it is the outside noises.

[fol. 1221] The Court: Both of you try to talk a little louder.

Mr. Fleming:

Q. Then, as I understand, you would come to Charleston and contact the State Treasurer and you would go to the bank in which the securities were kept?

A. That is right.

Q. And the Treasurer or his assistant or deputy would clip the coupons and deliver them to you?

A. That is right.

Q. During any of the period you were with Fidelity, did you ever have any securities deposited with the Auditor of State belonging to Fidelity?

A. Deposited with the Auditor?

Q. Yes.

A. In West Virginia our deposits were made with the approval of the Auditor, but custody of the securities was

with the State Treasurer. In other words, the State Treasurer would not accept for deposit or deliver securities to us from our deposit unless such transactions were approved by the State Auditor.

Q. Who purchased, or who had to do with the purchase of securities, say for the past nine or ten years, for Fi-
[fol. 1222] delity?

A. Well, the routine, or rather the practice followed there was that our investment department in New York would make recommendations for the purchases or sales of securities to our investment committee. The investment committee, acting upon these recommendations, would either approve or disapprove the recommendations. Now, on approval of a recommendation for purchase or sale, Mr. Young, who was in charge of our investment department in New York, would make the commitments.

Q. That is, he would act as the representative of Fidelity in making the purchases of securities?

A. Yes.

Q. Just explain to the Court how those——

A. Pardon me, Mr. Fleming; I just recalled that you said the last nine years.

Q. Yes.

A. I want to amend that, because Mr. Young, I believe, came with us in 1932. Well, that is nine years, approximately, so that stands as I stated it.

Q. Just explain in detail to the Court how these transactions were handled, Mr. Smith, please.

[fol. 1223] A. Mr. Young, on receiving the approval of the investment committee for a given transaction, would then make a commitment with the bond houses or brokerage firms and would then instruct their bank in New York to accept the bonds purchased against payments, or deliver bonds sold against payments. Upon completion of that transaction, the bank would advise, giving us the necessary details. We would prepare our records at Wheeling from that, using this advice from Mr. Young as to what he had bought for comparative purposes and checking purposes. The bank would return the bonds purchased in its own safe keeping vault for our various accounts, and from that point they would move to the various depositories in accordance with instructions given them by Mr. Young.

Q. And Mr. Young would act on instructions given him by you, or by some other representative?

A. No, he would be advised by Wheeling—I should say in the case of a deposit to cover a liability he would be governed by reports received from Wheeling as to the liability in a given state. Deposits made as replacements for securities to be withdrawn from a particular depository—well, he would be governed on that by his particular [fol. 1224] need for selling a security. By that I mean if it was advisable to sell certain of our securities on deposit in a state, he would buy other securities and ship them to the state involved against the withdrawal of the securities which he wanted.

Q. How many classes of contracts have been sold by Fidelity since you have been with the company, Mr. Smith?

A. Well, there was—the old ten year series.

Q. Was that special income?

A. That was the original series, and I believe it has been completely paid out. Then there was a Series C—the Series C and the income contract, the annuity contract, the Series B contract and the Series D contract.

Q. Series A?

A. And Series A, yes, sir.

Q. You have been with the company during the period when all of these contracts were sold?

A. That is right.

Q. In fact, you came with the company shortly after it was founded, did you not?

A. Well, about six years after it was founded.

Q. As these contracts would be sold, the money would [fol. 1225] come into the company, would it not?

A. That is right.

Q. And would it be allocated upon the books of the company to the contract fund from which the money was received?

A. Yes. All of the funds derived from a given class of contract holders were so earmarked. In other words, separate accounts were kept as to each series of contracts.

Q. In other words, as contracts would be sold the money would come in and would be earmarked to that particular fund, would it not?

A. Yes.

Q. Then those funds would be taken and invested in securities and the specific securities earmarked and or-

dered of record to the credit of that fund on the books of the company?

A. Yes, that is right.

Q. After that occurred, then the securities would start flowing into these various states where the contract was being sold for deposit with the state officials?

A. *Yes.*

[fol. 1226] Q. Explain those transactions to the Court, if you will, please.

A. In just what way, Mr. Fleming?

Q. Just how that was done—how the securities were deposited.

A. Desiring to deposit a block of securities with a state department, Mr. Young would write to the official in charge asking for approval of the particular security, and upon receiving that approval, he would give instructions to the bank in New York to forward those securities by registered mail, of course, to that state authority or that authority's agent. In some cases securities were deposited with a bank acting as trustee for a state. As an example, the deposit of the State of Missouri was in the custody of the Wheeling Dollar Savings and Trust Company at Wheeling, which was acting as the agent for the State of Missouri.

Q. You had the same situation in Tennessee, did you not?

A. Yes, Tennessee and in Virginia and Indiana.

Q. And probably Alabama?

A. And Alabama.

[fol. 1227] Q. When these securities were deposited with the various state officials, was any effort made to allocate or segregate those securities and keep them separated in the fund or for the benefit of the fund to which they belonged?

A. I received copies of all the correspondence that Mr. Young had with these various state departments; it was necessary that I have copies so as to know what was being done and so that our records could be made to conform to those instructions or conditions; and I do recall that in the case of one state a request was made to segregate the securities belonging to the Series B account, and if I remember correctly we were advised that such segregation could not be had because of the detail in maintaining records of that type.

Mr. Lauritzen: May we have that last answer again? I just couldn't hear that.

A. I say I did receive copies of all letters that Mr. Young wrote to the various state departments—in fact, all letters that he wrote to state departments and to banks dealing with the placement of these securities. If I recall correctly, [fol. 1228] I do recall seeing a copy of a letter written by Mr. Young to one of the states asking him to segregate the securities belonging to the Series B account, and I understand—in fact, I think there is a letter in our file wherein that state answers that they could not make that segregation because of the detail involved.

Mr. Lauritzen: The state answered, or Mr. Young answered?

The Witness: The state.

Mr. Fleming:

Q. What state was that?

A. I believe that was Illinois; I am not sure.

Mr. Fleming: We have that letter on file, I think.

Q. Did you have anything to do with assisting in procuring licenses to sell contracts in any states?

A. No, that didn't come within my department.

Q. Who handled that?

A. That, I believe, came under Mr. McNulty's direction. Of course, on that, if an application for a license to do business involved anything in the way of securities, reports we would naturally supply them or make them up.

Q. Do you know whether or not copies of the contracts [fols. 1229-1231] that were sold in the respective states were deposited prior to their sale with the proper state officials of that state?

A. Now, as to that, I can't answer for each state, but I am quite sure that copies of contracts were filed with at least most of the states before license was granted to do business. I believe that was a necessary requirement or a requirement necessary to obtaining a license.

Q. And those contracts remained on file during the period of the license?

A. I have every reason to believe that they did, yes.

. . . . . .

[fol. 1232] Q. Did you have any contract of any kind or any other signing or memorandum in writing in reference

to where these securities were to be deposited or how they were to be deposited during that period?

A. I don't think so. At least I have never seen a contract to that effect.

Debtor's Exhibit 58

At Mr. Fleming's request a paper was marked for identification as above indicated.

Q. I hand you here a paper marked Debtor's Exhibit 58, which you may examine, and I will ask you whether or not you have ever seen the original of which this is a copy in the files of Fidelity.

A. No, I don't recall seeing a copy of this, but this is in accordance with my understanding of the arrangement down here. In fact, all of my dealings down here have been on this basis. That is, the custody to the boxes was—could only be had in the presence of—well, in the presence of the [fol. 1233] State Treasurer or one of his deputies or two deputies of the State Treasurer and a representative of Fidelity, which might be myself or someone else delegated to that job, and a representative of the Central Trust Company.

Mr. Palmer: May I see that paper?

Mr. Fleming: Yes. (Handing it to him.)

Q. In other words, Mr. Smith, neither Fidelity nor the State Treasurer had control or custody over this property, but the control and custody was jointly in Fidelity and the State Treasurer, wasn't it?

Mr. Palmer: I object to that question, Your Honor. The state laws of West Virginia provide for that, and it is not a question of fact for this witness to testify to; it is entirely decided by the statutes of West Virginia and the legal interpretation thereof.

The Court: The state law might provide how it ought to be done, but if it was done in some other way the fact that the law says it ought to be done in that way would not change the facts. I overrule the objection.

Mr. Palmer: Read the question, please.

(The question was read.)

[fol. 1234] Mr. Palmer: My objection, Your Honor, is to the words "custody and control."

The Court: I will sustain it as to control, but not as to custody. Custody is a physical fact.

Mr. Fleming: I will strike out the word "control."

A. I feel that custody was in the State Treasurer, in that we had no voice——

The Court: Now, if the witness is going to answer the question this way I will have to sustain the objection altogether. I presumed he would answer as a matter of fact. It is not a question as to who he believes had it.

The Witness: May I change my answer?

The Court: Well, go ahead, if you know the fact.

A. Well, the custody was with the State Treasurer.

Mr. Fleming:

Q. But, as I understand, in order to obtain access or exercise that custody, Fidelity had to be present. Is that right?

A. That is true.

Mr. Palmer: I object to that, Your Honor. That is, again, a question of state law as to whether anyone had to be present or not. They may, as a matter of fact, have been present, but it is a question of state law as to whether any- [fol. 1235] one had to be present when the state officers exercised their control.

The Court: I will sustain the objection. I would like to ask a question or two myself.

Q. Who had keys to the safe deposit vault?

A. The State Treasurer.

Q. Anybody else?

A. No. No, there was a set of keys, a duplicate set, and those sets——

Mr. Townsend: I can't hear you.

A. I say the State Treasurer had the keys to the safe deposit chest. There were two bunches of keys, one a duplicate set, and both sets were in the custody of the State Treasurer.

The Court: Who paid for the deposit box?

A. Fidelity.

Q. In whose name was it carried on the books of the Central Trust Company, if you know, as the owner?

A. They were carried in the name of Fidelity.

The Court: All right. I just wanted to get those facts. Now you may go ahead.

Mr. Fleming:

[fol. 1236] Q. I will ask you whether or not under your agreement with the Central Trust Company it was possible for the Treasurer to obtain access to the box holding these securities without the presence of Fidelity?

A. No, it was not.

Q. Explain that to the Court.

A. That was—that was the arrangement made in the letter which you just gave me, in that the boxes were rented in our name.

Q. And you paid the rental on the deposit box, I understand?

A. We paid the rental, and while the boxes were in our name, we couldn't have access to them, neither could the Treasurer, unless both parties were present, and then—access was contingent upon a representative of the bank, naturaliy the custodian of the pass key.

The Court: As I understand, that was an agreement between Fidelity and the State Treasurer?

A. That was the instructions that came in the letter which they just passed here, making arrangements for the rental of these boxes.

The Court: I have not seen that letter, nor has it been [fol. 1237] introduced.

Mr. Fleming: I wonder where the original is. This seems to be a copy. You don't know where the original of this letter is, do you?

A. No, I don't.

Mr. Fleming: I understand Mr. Isaiah Smith has or can procure the original. I think that copy, Your Honor, was prepared by Mr. Smith from the original.

The Court: Any objection to introducing this?

Mr. Palmer: No objection that it is only a copy, but our objection to it is this, Your Honor, that regardless of whether the original was made by Mr. Johnson, then State Treasurer, no such agreement could be made by an official of the State of West Virginia which would bind any suc-

cessor of his, particularly in view of the state law, if these funds were deposited in accordance with the statute of the State of West Virginia, that the State of West Virginia and the Treasurer as custodian thereof, it didn't require any official of Fidelity or any bank to be present when the Treasurer undertook his custody, and no Treasurer had the right to enter into any such agreement. Now, for the [fol. 1238] practical end of it, in order for all of the parties to feel perfectly safe in it and the Treasurer to feel perfectly safe, he may have wanted other parties up there at any time he examined it, either Fidelity, Central Trust, or any outsider, so there could never be any accusation of anything wrong; but the agreement itself is entirely illegal, in that the statute of West Virginia is the only thing that can be binding.

The Court: I understand your argument on the point, but as to the reception of this letter for such bearing as it may have, you have no objection to the fact that it is a copy and not the original?

Mr. Palmer: None at all, Your Honor.

Mr. Fleming: We can substitute the original, if it is desired.

Mr. Palmer: We have no objection to its being a copy.

Mr. Huwe: I think it is common knowledge that where you have a statute you certainly are allowed to prove the terminology, and then, in addition, you are allowed to prove the administrative practice with respect to the administration of that statute. What the state offices did with [fol. 1239] respect to the administration of those positions is competent; and therefore any agreement, any request that a third party be present, or anything of that sort which is demanded or required by a state officer, is certainly competent evidence, and I think some of the things this man has testified to in that respect are competent under those circumstances. You are allowed to prove the administrative practice of the administrative officers trying to apply the conditions of the statute.

Mr. Fleming: This is offered on that theory, Your Honor, and I want to see if this arrangement was followed as outlined in that letter up to the time of the appointment of the receivers on April 10th.

Mr. Palmer: Perhaps Mr. Huwe doesn't realize that the letter purporting to be an agreement was signed by one Mr. Johnson, who was State Treasurer in 1929, and I don't

see how Mr. Huwe could argue, under his theory, that that is binding on Mr. Talbot, the present State Treasurer.

The Court: Mr. Fleming has just said that he proposes to follow this up by showing that the practice was followed [fols. 1240-1265] right up to the appointment of the receiver.

Mr. Palmer: We have no objection to showing what happened. Our objection is that no agreement made by Mr. Johnson would be binding, because the state statute provides for the custody and control.

The Court: I understand your objection on that. I will permit it to be introduced in evidence and marked.

Debtor's Exhibit 58

The paper referred to, which had previously been marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Fleming: I will ask you whether or not this same arrangement as contemplated in debtor's Exhibit 58, which you have just examined, was continued during the entire period concerning which you have testified, and particularly up to April 10th, 1941?

A. Yes, that was the arrangement under which the deposit was handled.

. . . . . .

[fol. 1266] By Mr. Lauritzen:

Q. Mr. Smith, I believe you testified that you were familiar with and received copies of letters that Mr. Young wrote when he transmitted securities out to the various states?

A. Yes, sir.

Q. Would you examine these letters, which appear to be letters addressed to the Banking Commissioner of Wisconsin, signed Fidelity Assurance Association by Hubert F. Young, and tell me whether those are such letters?

A. Yes.

Q. And are those typical of letters that Mr. Young wrote out at other times to the Banking Commissioner of Wisconsin and also to other state officials having charge of Fidelity's deposits?

[fol. 1267] Mr. Fleming: To this the debtor objects.

The Court: I don't believe I can rule on that without seeing the letters.

(Witness hands papers to Court.)

The Court: Are these letters being used for the purpose of showing that there was no designation made by Fidelity of any particular fund in which the securities were to be deposited?

Mr. Lauritzen: That is the purpose, Your Honor.

The Court: I overrule the objection.

Mr. Lauritzen: I don't want to encumber the record with these letters, Mr. Smith, but they run from January 11th, 1939, and the latest one is March 24th, 1941. There happen to be eight of those letters here, and as I read the letters they address the Banking Commissioner and then state "Complying with your request" of such and such a date they are forwarding certain securities and then they tell what the securities are and in what amount?

A. Yes.

Q. And are those the kind of letters that Mr. Young generally sent out to these various state authorities?

Mr. Flemin-: Mr. Young would be the best witness to [fol. 1268] that.

The Court: Well, this witness says he knows about it. I will let him answer.

A. I think they are—they are fairly typical of the letters that go out.

Mr. Lauritzen: It is a fact, isn't it, Mr. Smith, that though you had on your books separate accountings for various funds, as you testified, that when you complied with state laws in making deposits in those states there was no segregation made in this deposit in respect to various series of contracts, was there?

A. In the case of the State of West Virginia our deposit schedule indicated the fund to which the security deposited or withdrawn really belonged.

Q. By "deposit schedule" what do you mean?

A. Whenever we made a deposit or withdrawal from the State of West Virginia we prepared a schedule—this dates back to approximately 1933—we made a schedule showing the par value, the name and description of the security, the interest rate and date and the maturity and the market value, the fund to which it belonged.

Q. Then the letters that you sent to the State of West [fol. 1269] Virginia transmitting funds were somewhat different from these letters? Is that correct?

A. You see letters would not go to the State of West Virginia, since that deposit was handled differently than the deposits in other states. In other words, the only letters written—that is, generally speaking—pertaining to West Virginia would be letters which Mr. Young would write to me informing me that he was making certain shipments from New York and would I deposit those in West Virginia, and in turn ship to him certain securities which he wished to withdraw. I would take care of preparing the schedules and coming to Charleston would present that schedule to the state officers.

Q. Do you have any of those schedules with you?

A. I do not have any with me, no.

Q. And you say that practice was followed since 1933?

A. Yes, approximately.

Q. Do you know what the purpose was in giving more information on those schedules that you filed with West Virginia than you gave on letters to the other states, including these written to Wisconsin?

A. That was made at the request of the Securities Com- [fol. 1270] missioner and the State Auditor's office.

Q. Do you know whether or not the securities you had on deposit in West Virginia actually covered, fund by fund, the contract liabilities which those securities were securing?

A. No, I don't have enough information on that. The calculation of the liability on the funds would not come within my department, and my concern would be purely with the value of the securities.

Q. Do you know whether, with respect to the State of West Virginia or any other state, Fidelity ever undertook to have on deposit in West Virginia or any other state securities, fund by fund, back of contracts fund by fund?

A. Well, that situation doesn't exist in all states. In other words, there are some deposits, or there are states in which contract deposits are in excess of requirements and where deposits to other series are less than requirements.

Q. And isn't that true in West Virginia?

A. That would all depend on how it was being calculated. If you are speaking only of West Virginia liability——

[fol. 1271] Q. No, I mean the whole West Virginia deposit. The law required that you lay down a deposit here for all contract holders everywhere, if you will recall?

A. Except that we would be given credit for deposits made in other states, that is, where the deposits were required by law in other states.

Q. Yes, sir.

A. No, I don't know what the comparison is between the value of securities and the liability. I am not familiar with the liability figures.

Q. Well, generally speaking, in most every state that had a deposit there was no segregation of funds there against any particular contract series, was there? You know that of your own knowledge.

A. No, that is just what I said earlier, that some states—one state in particular advised us that they could not maintain separate records.

Q. You mean that you had asked that state to maintain separate records?

A. Yes, I believe every state was asked to separate the—I am speaking now—to separate the securities of Series B from those held for other accounts. That was in ac-
[fol. 1272] cordance with the indenture contract itself.

Q. Will you get me one letter where you asked a state to do that? Can you find that for us.

A. I will try to. I don't know whether that letter is in Wheeling or whether it is in New York.

Q. Mr. Smith, what would be the point of Fidelity asking the states to make a segregation when the state doesn't know where the securities come from? You just send them out a batch of securities and you presumably have the information on your books as to what fund the securities came from.

A. I would come back to the State of West Virginia and answer it this way, that in making up the schedules of securities deposited or withdrawn, we indicate the fund to which those securities belong, and in the case of the physical securities themselves, securities belonging to the income contract account, the annuity contract account and the income reserve Series A account are filed in a chest separate and apart from those belonging to Series B and separate from Series D. In other words, securities belonging to Series B account and the securities belonging to Series D account are filed separately.

[fol. 1273] Q. How long have you maintained that practice?

A. That has been in force ever since the first deposit was made to the Series B and the first deposit made to the Series D.

Q. On what date?

A. I don't recall the date.

Q. Well, is it within the last two or three years?

A. No, it goes back further than that, I am quite sure.

The Court:

Q. Are there any of these Series B in Wisconsin?

A. Yes, I believe there are.

Q. Then why were not deposits made separate there as well as in West Virginia?

A. Well, I can't answer that, because I don't have any correspondence or any knowledge what the negotiations were between my superiors and the State of Wisconsin.

Mr. Lauritzen:

Q. Who would be the person that would know all of the detail upon this particular subject that we are talking about now, beyond any question of doubt?

A. I believe Mr. Young would be the man, because he [fols.1274-1278] was responsible for making those arrangements, that is, when he took over that particular office.

. . . . . .

[fol. 1279] Q. And it was at your insistence that both Mr. Smith and Mr. Thomas were appointed West Virginia state court receivers?

A. I insisted on Mr. Smith's being put in. A representative of the company suggested that there be two.

Mr. T. C. Townsend: What was that last answer?

(The answer was read.)

The Witness: Calling my attention to the fact that Mr. Thomas had prepared the filing of papers with the Securities and Exchange Commission. Believing that the knowledge gained from the study of the company in making up those papers would be very valuable in analyzing this company and preparing any kind of reorganization plan, I [fol. 1280] agreed.

Cross-examination.

By Mr. Fleming:

Q. Mr. Sims, who prepared the petition that was filed in the local state court?

A. Who actually did the writing I do not know. Mr. Partlow, of the Attorney General's office, was in conference with us in regard to it.

Q. It has been suggested that Mr. Thomas prepared the petition.

A. I did not see him.

Q. Who did you consult with from the firm of Koontz and Koontz during that time?

A. I talked with Mr. Koontz before the suit was brought and told him what I was going to do.

Q. Well, he advised with you, did he not, in reference to it?

A. Well, in a general way, but I was advising him.

Q. I will ask you if it is not a fact that your petition was prepared in the law office of Koontz and Koontz?

A. You had better ask them.

[fol. 1281] Q. You don't know who prepared it?

The Court: State, if you know, Mr. Sims.

A. I do not know of my own knowledge.

The Court: All right.

Mr. Fleming:

Q. Who presented it to you for your verification?

A. Well, I can't say whether it was Mr. Partlow or a member of the Koontz firm or who.

Q. And who presented it to the Court at the time it was filed?

A. I do not know.

Q. You were not present at that time?

A. My assumption is Mr. Partlow, of the Attorney General's office.

Q. You were not present at the time?

A. No, sir.

Q. You did not go into court?

A. No, sir.

Q. You made no request of the Court as to who was to be appointed receiver?

A. Oh, you mean the court receiver down——

Q. The state court?

[fol. 1282] A. Oh, the state court.

Q. Yes.

A. Mr. Partlow was there, at my request.

Q. Who else was there—what other attorneys?

A. Mr. Koontz was there representing the——

Q. Company?

A. Company, I suppose.

Q. You don't know who prepared the petition?

A. Not of my own knowledge, but my assumption is that Mr. Partlow did.

Cross-examination.

By Mr. Huwe:

Q. Mr. Sims, are you prepared and able to tell us the exact date when those Marston and Paull securities were withdrawn by the company from Charleston?

A. No, sir.

Q. Who would be able to tell us the exact date when it was withdrawn and restored—partially restored?

A. Mr. Robert Brown.

Q. Is he in town again? He is still in town?

A. I don't know. I have not been to the office since away last week until this morning, and I left before he came in.

[fol. 1283] Q. Is it your knowledge that he has been on the job for the last few days?

A. I think he has, perhaps.

Mr. Huwe: All right; thank you.

The Court:

Q. Mr. Sims, there is something I want to ask you. You said awhile ago that a representative of the company suggested that there be two receivers. Who was that representative?

A. Mr. Koontz.

Q. What Mr. Koontz?

A. A. B.

Q. A member of the firm of Koontz and Koontz?

A. Yes, sir.

Q. And was he the one that suggested Mr. Thomas?

A. Yes, sir, and to clear my own reputation, if that be at stake, I call attention to the fact that Mr. Thomas was a member of their firm. I didn't know about the ethics of

that, but all things considered I would waive that because of Mr. Thomas' knowledge that I wanted to avail myself of in connection with the reorganization plans.

[fol. 1284] The Court: All right.

Cross-examination.

By Mr. Lauritzen:

Q. Mr. Sims, you became familiar and rather intimately acquainted with the Fidelity sales practices here in the State of West Virginia during your supervision, did you not?

A. Well, more or less, yes.

Q. Can you tell us what use the company made in its sales campaign here in West Virginia of the fact that they had a deposit with the State Treasurer of West Virginia under the laws of West Virginia?

A. I believe I saw a prospectus of the company containing much sales literature in which was shown the vault in the State of West Virginia in which their securities were kept.

* * * * * * *

[fol. 1285] Mr. Lauritzen:

Q. Mr. Sims, do you know whether it was a fact that here in West Virginia a large part of the sales campaign of Fidelity was based upon the fact that purchasers of contracts here in West Virginia would be protected by the state deposit?

A. There isn't any doubt about it.

Q. You know that of your own observations of this company?

A. Yes, many owners of contracts came to me and stated that they were informed that——

[fols. 1286-1292] Mr. Fleming: I think the debtor will object to any conversations between the Auditor and contract holders as purely hearsay and entirely beyond the realm of proper proof.

The Court: Well, I don't see any objection to that. I think the Court will take judicial notice of the fact that that played a large part in the sales of securities, the fact that we have such a statute as that. Still, if you want to go ahead, it is all right.

The Witness: Read the answer.

(The question and answer were read.)

A. That the State of West Virginia was behind the contracts. I had arguments with the holders of contracts.

. . . . . .

[fol. 1293] C. E. Smith, recalled, testified as follows:

Cross-examination.

By Mr. Lauritzen:

. . . . . .

[fol. 1294] Q. Are you familiar with the provisions of the contracts that Fidelity sold?

A. No, I am not. It has been so long since I was in that particular division of the company that I have forgotten most of the terms.

Q. We were talking about the fact that there were various series of contracts, A, B, C and so on, and you testified that securities were placed in those various funds and were earmarked, so to speak, on the books of the company with respect to those funds.

A. That is right.

Q. It is a fact, is it not, that with respect to the fifteen states which required deposits that those securities when they were sent out to those states did not bear any particular earmark?

[fol. 1295] A. I don't think that that would hold true in all cases. I believe——

Q. I would like to have you be very careful and particular about this and get the information for us, if you don't have it here, and tell us precisely what was the situation in that regard. If you remember now, I wish you would tell us.

A. Prior to the issuance of the Series B contracts I don't think that any earmarking was indicated.

Q. And when was the Series B first issued?

A. And when the Series B was first issued—I don't recall the date of the first issue——

Q. Was it around 1934?

A. I think that is about correct—a deposit going out to states, other than West Virginia, as I recall Mr. Young's

letters indicated those securities were for the Series B account.

Q. To West Virginia?

A. Other than West Virginia—that is states other than West Virginia.

Q. Would you say that held true for Wisconsin?

A. Yes, I think it did.

[fols. 1296-1305] Q. You looked at those letters that I showed you yesterday, and you didn't see——

A. There was nothing in there of that nature, but I am speaking of the earlier letters they had just when the first deposits were being made for the Series B fund. One thing I do recall, no Series B and Series D, and that is that the indentures required that the securities belonging to those funds be kept separate and apart from the securities belonging to other funds.

Q. What indenture do you speak of?

A. The terms of the contract.

Q. The terms of the contract in the Series B was the same as the terms of all the other contracts with respect to the maintenance of reserves, was it not?

A. I believe there is a reference in there to the assets of the Series B fund, in which it stated that those assets should be kept separate and apart from the assets of other reserve funds.

* * * * * * *

[fol. 1306] Mr. Lauritzen:

Q. Mr. Smith, after you have sold a large amount of one series of contracts in one particular state, and then you abandoned that series and that series began to mature and then you started selling another series, it wouldn't be very practical to ascertain from day to day what your growing liability on the new series was and to have at all times out in that state securities purchased with cash arising from those particular sales going on at that time, would it?

A. No, it would not have been practical. In fact, I doubt whether it would have been possible to do it that often, that is, on a day to day basis. As a matter of fact, just in recent years the taking of an inventory by states was quite a task.

[fol. 1307] Q. Isn't it a fact that if you wanted to unscramble all these securities now and yet comply with each

state law, from your knowledge of that securities port folio it would be impossible?

A. I don't think it would be impossible, generally speaking.

Q. Have you examined the securities to see whether you could unscramble them and yet have enough securities of the particular kind acceptable in each of the fifteen states where you had deposits?

A. I don't think you could find enough to—that is, I don't think you would get enough of the acceptable types to cover the requirements of all fifteen states, but you could certainly do considerable to cure the present deposit deficiencies.

Q. In what states?

A. Well, take Wisconsin, that requires securities, I believe, either government or Wisconsin municipals.

Q. And that is what you put out there, isn't it?

A. Yes, we have got those out there. There are, I believe, still some industrial and utility bonds out there which were deposited before—before the——

[fol. 1308] Q. Before the present law?

A. Before the present requirements were instituted.

Q. Before what I am speaking of, rather than that, Mr. Smith, is if you would make an attempt to place securities series by series and series for series in each state and still meet the state requirements, your knowledge of the securities port folio of this company would tell you that that couldn't be done, wouldn't it?

A. Well, I still would like to have a whirl at trying to do it.

Q. How long have you been trying to do it?

A. Well, as I say, there has been considerable effort made since 1939 to cure that. The whole thing—I shouldn't say the whole thing, but a good deal, revolves around the willingness of the officials of the various states to release bonds of one type against the deposit of bonds of another type. It is a matter of releasing them for a period long enough to get them into transit.

Q. But you were never successful in accomplishing that?

A. Not entirely.

Q. Did the states fail to cooperate with you that regard?

[fol. 1309] A. I don't think you could call it failure to cooperate. They simply wished to protect themselves, because it would mean the surrender temporarily, for perhaps

a day or two, of certain securities by one state in order to get that deposit in another state against a withdrawal in a second state which would go back to the first state.

Q. You never made any proposition to the various states that they should consult between themselves and make the changes, did you?

A. No, I didn't mean to indicate that such a proposition had been made.

Q. As a matter of fact, some of the states, after the SEC proceedings, definitely told you to put down securities fund by fund in their states, didn't they?

A. I can't answer that, because I don't know.

Q. Who would have information on that?

A. I believe that would go to Mr. Young. It should, because he was in charge of making the deposits.

Q. Let us suppose that in some manner you and Mr. Young had succeeded in unscrambing this whole thing, and [fol. 1310] going on the theory that you had to have securities fund by fund in each state and still meet the deposit requirements, now before many days or a month had gone by and you began to sell various series contracts in various states, you would be out of balance again, wouldn't you?

A. Yes, you would be, as a temporary thing. You would at least—you would at least be out of balance until an inventory of your liability was taken, and once that was determined it would be a matter of getting your deposits in agreement again.

Q. You never attempted to maintain any records in your company that would enable you to keep any such balance of deposited securities, did you?

A. Not in all states. There were a few states that requested monthly reports of liability in their respective states.

Q. And in their respective funds?

A. They did not, as I recall—at least, we didn't prepare our securities values by funds. We prepared them en toto.

Q. Yes.

[fol. 1311] A. And that was with the exception of Wisconsin, which—oh, I think back as far as 1939 or 40 asked us to submit reports of deposits and liability by funds.

Q. The other states didn't ask you to do that?

A. I couldn't answer that accurately, because, as I state, the request from the states would not come to me.

Q. Who was it, in your firm, that had charge of looking over the various state laws and then handling the mechanics of Fidelity's complying with those laws?

A. Well, that would come under Mr. McNulty's jurisdiction.

Q. Mr. McNulty's?

A. That is as far as maintaining contacts between the states and Fidelity is concerned. From there on it would mean other departments working in with him.

Q. And if the state officials in a particular state were satisfied with the deposit that you had made there and in accordance with Fidelity's reading of the state law in making that deposit you had complied with the state laws, wouldn't you consider that you had then done enough?

[fol. 1312] A. I would consider that we had done all that could be done, yes.

Q. And it wouldn't make any difference as to those deposits whether you had fund for fund in those states, if the state law didn't provide for it, would it?

Mr. Huwe: Your Honor, I object to that particular question for the reason that he is asking this witness his opinion about a legal question. In other words, the legal question is whether or not the debtor company was obligated by the state laws or by the West Virginia laws to maintain these liability deposits in the respective states in proportion to the cash surrender liability in those respective states. This witness is incompetent to give a legal conclusion on that question, and the question that Mr. Lauritzen has asked him requires such a conclusion. After all, even if the debtor, with intention or accidentally and innocently, violated its trust obligations by putting more, we will say, series B securities in one state than belonged in that state, that is a question that is a violation, perhaps, of the obligations, regardless of the intention of any of the company's officers or of any particular employee of the company, or [fol. 1313] regardless of that particular employee's particular opinion of what he should do or should not do, so I think that that question is objectionable for that reason, asking for that kind of conclusion.

The Court: I sustain the objection.

Mr. Lauritzen: I think I can explain my purpose to Mr. Huwe. Mr. Smith has answered that he felt that they should do certain things, and I asked him what led him to

that conclusion, and apparently it was based upon what his interpretation of the contracts would be, which I will grant you is perhaps a question of law, but I am trying to bring out here what the actual practice and operation of this firm was over the entire period of their business career with respect to living under the various state laws under which they operated, and I think that is highly pertinent——

The Court: You can do that, but the question you just asked is objectionable, in my opinion.

Mr. Lauritzen: Well, I will withdraw the question. Will you read the question?

(The question was read.)

Mr. Lauritzen: I will withdraw that.

[fols. 1314-1315] Q. Mr. Smith, it seems clear that you did not have fund for fund in the various states. I guess we all concede that, don't we?

A. That is correct.

Q. And yet for a long period of years you operated in those states and apparently the state authorities were satisfied with your deposits there and the fact that you had in other respects qualified under the state laws? Is that correct?

A. Apparently so, yes.

* * * * * * *

[fol. 1316] By Mr. Schurr:

Q. Mr. Smith, for our information, it was the policy of the company not to earmark funds prior to the issuance of B Series, or maybe at a later date, when the SEC brought the injunctive proceedings—is that correct, sir? What I mean, the states did not require the earmarking of securities?

A. You are speaking of deposits?

Q. Yes, there was no state law in West Virginia under which you operated requiring the earmarking of securities for a particular fund or series of contracts, was there?

A. Not that I know of, but actually the securities were earmarked on our records, that is, for a particular fund, irrespective of the place of deposit.

[fols. 1317-1320] Q. But I mean for some time the company operated prior to the proceedings instituted by the

SEC—it was their policy not to earmark any funds, was it not?

A. No, because the Series B issue had come out before the SEC proceedings, and the Series B securities were earmarked.

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[fol. 1321] Q. You were familiar with the fact that a consent decree entered in that case in Detroit enjoined this company from failing to maintain in West Virginia and other states sufficient securities to meet the deposit requirements and at the same time from failing to segregate and maintain at all times sufficient statutory deposits against appropriate liabilities and from failing to create and maintain separate contract reserve funds, are you not?

A. Yes, I am familiar with that.

Q. After that decree were entered the company undertook to comply both with the injunction restraining it from *maintaining* the required deposits in the states and that phase of the injunction that prohibited it from *maintaining* sufficient reserve requirements on the different series of contracts.

[fols. 1322-1330] A. I think every effort was made, yes, to comply with the order.

Q. You couldn't do it because the company was insolvent and broke?

A. Well, that is very likely.

• • • • • • •

[fol. 1331] Mr. Fleming:

Q. I will ask you to explain why you say those items were worth par?

A. Well, take the home office mortgage. That is our home office building in Wheeling, built in 1937 and 1938.

Q. At what cost?

A. At a cost of approximately $450,000; and here is a mortgage, including the first and second, of $450,000. I [fol. 1332] think that—on that particular mortgage I think the value is behind it, surely.

Mr. Palmer: We object to the answer. The witness has not qualified himself.

Mr. Fleming: Let me find out what this other real estate mortgage is.

The Court: Well, let's see about that answer first. He gives you the cost in 1937, says it is mortgaged to the full amount of the cost, and then says he thinks that there is full value behind it. I think the answer itself shows that this witness is not acquainted with the fact that real estate always deteriorates somewhat after construction.

Mr. Fleming: I had the impression, Your Honor, that this other real estate item of $215,000 was mortgage on real estate other than the home office.

The Witness: Other than the home office.

The Court: I will strike out the answer if it is objected to.

Mr. Fleming:

Q. Then, Mr. Smith, as I understand, the home office mortgage in the sum of $296,790 was upon the home office [fol. 1333] building at Wheeling, which was constructed two or three years ago at a cost of $450,000.

A. That is right.

The Court: Four years ago, he says.

A. '37 and '38, the home office building, about three years ago.

Mr. Fleming:

Q. And the item "other real estate mortgages" in the amount of $215,000 consists of mortgages upon other real estate?

A. On other real estate, yes.

The Court: Let's see. I want to get this straight, because unless we do it won't do me any good. This witness said a minute ago that he had two mortgages there amounting to $450,000 on the home office building, in other words, the exact cost of it. Now you are restricting it to one mortgage of $296,000.

A. Your Honor, the first mortgage on the property, which is on deposit with the State of West Virginia is $296,790. Then there is a junior mortgage on the property of $153,210.

Q. Where is that one?

A. That is in the hands of the trustee.

Mr. Palmer: Speak up, Mr. Smith; we can't hear you. [fols. 1334-1337] The Witness: Oh, pardon me. I say that is in the hands of the trustee, I believe.

The Court: That would seem to be the one whose value might be questionable, then.

Mr. Fleming: Yes. I might be mistaken, but I had the idea that this "other real estate mortgages," $215,000, did not include that mortgage.

The Court: Let's see if it does.

Mr. Fleming:

Q. Does the item of "other real estate mortgages", included in the schedule marked debtor's exhibit 57 and bearing date December 31, 1940—include the second mortgage upon the home office building concerning which you have just testified?

A. No, the item marked "other real estate mortgages" of $215,000 does not include that second mortgage.

. . . . . .

[fol. 1338] Q. Well, take the schedule as of April 10th. That covers those same properties, doesn't it, and in the same amount?

A. This is the same amount.

Q. Yes. Isn't — a fact, Mr. Smith, that Fidelity at that time only had eight properties in all?

A. That is true.

Q. Well, if they only had eight properties and that was all the real estate it had in that schedule, would it be possible for you to reconcile that figure with the ownership of those properties?

A. Yes. Here is the point. In these assets the home office building is covered here under mortgages, since it [fols. 1339-1343] is under mortgage, and it is covered under that title, so that the $438,105.11 as of June 6th would be the other properties.

. . . . . .

[fol. 1344] The Court: Mr. Smith, I gather from all these [fol. 1345] answers of yours that with the exception of the home office building, which you think is worth about what it is carried on the books for, and the lots in Parkersburg, that with reference to the other real estate there is a difference of approximately twenty to twenty-five per cent in the actual value and the value at which it is carried on the books. Does that about get it?

A. I think that would be a fair valuation.

Mr. Fleming:

Q. As to the item of $153,000 which you have testified comprised a second mortgage upon the home office building, where is that item carried?

A. With reference to this schedule, you mean?

Q. Yes. It is carried in the securities, I assume?

A. Yes, it is carried in the securities.

Q. You may explain to the Court, if you will, how that particular item was valued by you in making up this schedule.

A. That was valued at book value, just as——

Q. It was valued at book value?

A. At book value, yes.

Q. What would be your opinion about that now? Would that be worth quite book value, do you think?

[fol. 1346] A. That is difficult to say. I think it would be, very close to it.

Q. You think it would be?

A. Yes.

The Court: Well now, how would that be possible, Mr. Smith, in view of the fact that you say the home office building is not worth more than $425,000 as a maximum? You gave a minimum, I think, of $375,000, and there is a prior mortgage against it of $296,000, and then you have this mortgage of $153,000, how could this mortgage possibly be worth its face value?

A. That doesn't seem—it doesn't seem possible.

The Court: No. It doesn't to me.

Mr. Fleming: I think probably this mortgage should be evaluated in the light of his previous testimony.

The Court: Yes, you may proceed. The Court will draw his own conclusions.

Mr. Fleming:

Q. You say you have been with Fidelity since 1917?

A. Yes, 1917.

Q. Have you been acquainted with the character of the business transacted by Fidelity and its activities during [fol. 1347] that entire period from 1917 up to the present time?

A. Yes, in a general way.

Q. I will ask you whether or not Fidelity ever engaged in any business, either in West Virginia or outside of the State of West Virginia, other than the sale of these contracts concerning which you have testified?

A. No, not that I know of.

Q. The special annuity and the special income and the A, B, C and D classes of annuity contracts?

A. No, I don't know of any business other than contracts.

Q. I will ask you whether or not during this entire period the books of the company were open to inspection to the officials of the various outside states in which Fidelity was selling these contracts?

A. Oh, yes, they were open at all times for inspection.

Q. And I will ask you if, from time to time, representatives of those various states came to Fidelity for the purpose of ascertaining the nature and character and amount of your assets and the manner in which your business was [fol. 1348] being handled and transacted?

A. Yes, there would be periodical examinations by representatives of the various states.

Q. And if at times representatives—that is, what might be termed convention representatives representing all of the states in which contracts were being sold—came to your home office for the purpose of ascertaining all facts relative to the operation of your business?

Mr. Palmer: If Your Honor please, I do not want to object to this, but it has been gone over even in greater detail than Mr. Fleming is going over it now earlier in the case.

Mr. Fleming: I am not wanting to go into details; I just want to cover it generally.

The Court: Go ahead. I think it has ben covered by another witness, but there was a little controversy about it as I recall——

Mr. Lauritzen: May it please the Court, we have another objection to the question, when he asks with reference to all states and the purpose of the men coming in there to examine for all purposes, I don't see how the witness can possibly give an answer as to all facts.

[fol. 1349] The Court: Read the question.

(The question was read.)

The Court: I overrule the objection.

A. The convention representatives were at the home offices in 1940 and at various times there were other representatives of other states that would come in and make their examination.

Q. You were explaining to the Court, Mr. Smith, that each fund, as representing the contracts sold in that fund—you have your records by means of which that fund is kept entirely separate and apart from each other fund. Is that right?

A. That is correct.

Q. And that all securities purchased through the use of monies obtained from the sale of contracts in that fund are earmarked and kept separate for the purpose of identification?

A. On our records, yes, sir.

Q. As to that particular fund?

A. That is right.

Q. You have a ledger showing each specific fund and the amount of money that has come into the company through [fol. 1350] that fund and the amount of securities and the character of securities purchased with those moneys?

A. Yes.

Q. As a matter of bookkeeping, just explain to the Court, if you will, how your bookkeeping transactions are handled, both as to the monies received through the sale of contracts in each specific fund and how the securities are handled, as a matter of bookkeeping, so they will be allocated and identified in relation to each specific fund.

A. I believe that the simplest answer to that would be that the collections from contracts are credited on it and the contract payments or money placed in the bank; and as your cash available accumulates the investment department would make recommendations to the investment committee for the purchase of securities, and when and if the securities were purchased, they would be allocated to whatever fund was in need of investments and that fund would pay for them.

Q. In other words, Mr. Smith, you could go to your own records, and if Fidelity had purchased a bond ten years ago from funds of Class A contract fund; you could find [fol. 1351] the number, the serial number of that bond and the amount of it?

A. Yes.

Mr. Farmer: If the Court please, I will take an objection to this question. It seems to me that is unnecessary repetition.

The Court: I overrule the objection, but I would like to ask this question.

Q. You say that the payments came in and they just went into a general fund?

A. No, no. They went into—they were credited to the contract fund and to the contract to which they belonged, the money going to the bank account—what I meant to say—what I should have said—was that as the payments from the contract holders were received they were credited to those contracts or to the contract to which they were meant to apply and were then deposited in the bank.

Q. Were they deposited in the bank just in a bank account of the Fidelity Investment Association or were they deposited there to some particular fund?

A. No, we have eleven bank accounts, one for each fund.

[fol. 1352] Mr. Palmer:

Q. That was as of what time? When did you start the eleven bank accounts? I think the Court would like to know that.

The Court: Yes.

A. I can't recall the exact date.

Mr. Palmer:

Q. That was after the SEC suit in Detroit? Up till then I think you told me yesterday you had one bank account, although you separated it on your own books?

A. I don't believe I gave that testimony.

The Court: What was the fact about that? When did those separate funds start, or did you maintain them from the beginning? I mean the separate bank accounts for the individual funds.

A. I can't very well answer that, because that question comes under the head of accounting, and I am not familiar with the accounting practices as affects accounting in general. Where it pertains to securities, the securities themselves I can answer——

Mr. Fleming: Mr. Schellhase is still here. Could he clarify that point?

A. I am quite sure he could.

[fol. 1353] Mr. Fleming: That is all, Mr. Smith, for the present.

Cross-examination.

By Mr. Palmer:

Q. You spoke of the Reymann property at Fifteenth and Eoff Streets as being worth twenty to twenty-five thousand dollars. Is that correct?

A. Yes.

Q. How long have you had that property?

A. That was acquired in the latter part of 1940 through foreclosure.

Q. How long have you had a mortgage on it?

A. That would go back, I believe, as far as ten years.

Q. And you have not had an offer to buy it in that time, have you?

A. Not that I recall.

Q. And it is situated catercornered from the county jail, isn't it?

A. That is right.

Q. And on the other corner is a mortuary?

A. Right.

[fol. 1354] Q. And on the other is the Elks Club parking lot?

A. That is correct. Wait a minute. Yes, that is correct.

Q. And it is a three story residential building of the old ornate type of fifty or sixty years ago—isn't that right?

A. That is right.

The Court: Are you considering the house as of some value, the building itself?

A. I stated that at prevailing prices it would be worth between twenty and twenty-five thousand——

Q. I mean, were you considering the building as a part of that value or were you just thinking of the land?

A. No, I was considering the building as included in that.

The Court: All right.

Mr. Palmer:

Q. Your tenants are the American Red Cross, the Boy Scouts and so forth, aren't they?

A. That is right.

Q. It is situated at least four to five blocks from the business section and the office section of the City of Wheeling? [fol. 1355] A. That is correct.

Q. Have the other valuations that you placed on real estate been on the same basis that you have valued this property on?

Mr. Fleming: I think we will object to this. This calls for a comparison, and——

The Court: Overruled.

The Witness: Your question again, please.

(The question was read.)

A. Yes.

Mr. Palmer:

Q. The Howard mansion that you are talking about was built about 1912, wasn't it?

A. That is correct.

Q. You have not had an offer to buy it since Fidelity has had it, have you?

A. Not that I recall, no.

Q. You cut it into apartments and the apartments are so big in size, that is, the rooms, that you have had great difficulty in even leasing it? Isn't that right?

A. That is correct.

Q. And in fact you have even had to pay the gas bills on some of the apartments because the gas bills are so [fol. 1356] enormous compared to the size of the apartments? Is that correct?

A. That is correct.

Mr. Palmer: In order to clear up one other thing—I have mentioned this to Mr. Fleming, and perhaps it will clear up something in the Court's mind—the statute of West Virginia requires a company such as Fidelity—first requires the Insurance Commissioner to require a deposit in the amount of $100,000, and after that the only duty is upon the company to keep the deposit up, and not upon the Insurance Commissioner or Auditor or Treasurer. In other

words, the Court was asking yesterday how funds could be taken out. There is no provision stopping the company from taking out any funds at all, or giving the Auditor any right to stop them, other than to put them into receivership proceedings. The single provision of the statute is that the company shall make this deposit and maintain it, and the Auditor wasn't given any power over that.

The Court: What does the statute say will happen if the company impairs its deposit?

Mr. Palmer: The Auditor can revoke their license.

[fol. 1357] The Court: Then that does give the Auditor practically the power to require it, doesn't it?

Mr. Palmer: Insofar as the funds or securities are impaired, but the duty of maintaining them is upon the company, and that is what I wanted to ask this witness about, with that in mind, Your Honor.

Q. Every time a person makes a payment on their contract, that meant that the company had a greater liability to that individual, isn't that true?

A. That is correct.

Q. And every day you had payments being made in hundreds of dollars upon contracts?

A. That is right.

Q. So that theoretically you would be required to immediately increase your deposit with the State of West Virginia or whichever state the money came from—isn't that right?

A. That is correct.

The Court: Wait a minute. You lose sight of the fact that contracts were maturing, don't you?

Mr. Palmer: I am going to come to that, Your Honor.

Q. It was impossible, as a practical matter, to make a [fol. 1358] deposit every day to meet the payments coming in? Isn't that true?

A. That is true.

Q. So that as a practical matter you did the best you could by making deposits in lump sums to cover payments which had been made individually over a period prior to the deposit?

A. That is right.

Q. And also isn't it true that the bond market fluctuated up and down?

A. Yes.

Q. The securities market?

A. That is right.

Q. So that from time to time you had with the same deposit a higher value and a lower value, depending upon the outside securities market?

A. Yes, that would contribute to a change in the deposit value.

Q. Now, is it also true that you had from time to time contracts maturing whereby you were paying off and thereby decreasing your liability? Isn't that true?

A. That is correct.

[fol. 1359] Q. Wasn't it impossible for you to make a differentiation between deposits made with the State in order to comply with the laws as to payments made and at the same time take deposits out where you were making payments back to maturing contract holders?

A. It would be quite difficult to do.

Q. In other words, I have this in mind. Your maturing contracts, were they older contracts? Is that true?

A. That is true.

Q. And the ones on which you were getting your liabilities increased by payments were the newer series of contracts? Is that correct?

A. That is correct.

Q. Now, using this only for an example, and not concretely in any manner, take the State of Wisconsin. If you had a sufficient deposit up there to meet all of your liabilities and the maturing contracts, say of the income series, were paying out at the rate of a hundred dollars a day, you were selling new Series B at the rate of a hundred dollars a day, so that your fund was always perfectly solvent according to their state laws—you didn't attempt [fols. 1360-1370] to take out a withdrawal periodically and put it back into that same fund, did you?

A. No, I don't think it was done on that basis.

Q. And as a practical matter it would have been impossible to make such withdrawals and redeposits from day to day, would it not?

A. That is correct; it would not be practical to do it.

Q. What you mean, from an economic standpoint, the expense of trying to keep books up to date and mailing your securities and receiving them would have required too large a force to do it as a practical matter?

A. That is right.

Q. So when you had a deposit that was sufficient to meet all liabilities, considering the balancing of outgo and intake of the company, you let that deposit sit there?

A. That was what was done, yes.

* * * * * * *

[fol. 1371] Mr. Huwe: Your Honor, I would like to present my amended answer for filing. I think all counsel have had an opportunity to examine it. I don't believe they have the right—they have the power but not the right, as I see it, to oppose it, for the reason that there is nothing that prohibits the creditor from amending his answer under the provisions of Chapter 10.

The Court: Not so long as it remains an answer controverting the allegations of the petition. That was the question I asked. Is it still in that category, or is it different from that?

Mr. Huwe: It raises no new issues. However, it does join in the prayer of the debtor, or rather, joins in the desire of the debtor in one of the sections where the debtor alleges its desire to be reorganized.

[fol. 1372] Mr. Palmer: If Your Honor please, the assistant Attorney General of the State of Ohio showed me a letter signed John J. Rivers just before lunch in which he asked that this company be not reorganized but be liquidated and give him his money. Now, here is Mr. Huwe's inconsistent position. That letter was written to the Attorney General of the State of Ohio and the Insurance Commissioner asking for relief.

Mr. Huwe: If you will examine that letter—I saw that letter, and it stated, back in May before the federal suit was brought, as far as I can recall, and even as late as August 4th, the initial days of this proceeding, Mr. Rivers and others were of the opinion that every one of the respective funds of the debtor belonging to contract holders were insolvent. The first two days' proceedings developed sufficient testimony to show that perhaps a majority of those funds were solvent. Then further testimony by Mr. Smith, by Mr. Schellhase and by others revealed that the majority of those funds are solvent.

Back on August 6th Mr. Rivers and myself filed a memorandum with the Court with respect to jurisdiction. At that

[fol. 1373] time, unaware of any activity of the trustee suggesting that the company be reorganized and even suggesting certain preliminary plans with reference to the deposit—at that early date we were convinced from the testimony and reports that had been submitted by the trustee, exhibits A and M, as well as by the testimony, of Mr. Smith, the ex-receiver, that a majority of the funds were solvent; and consequently, under those circumstances, we had to change our minds about the feasibility of reorganization; and that explains the difference. It is a difference of somebody who has been enlightened by the testimony and reports.

Mr. Palmer: The letter says "I want no part of any rehabilitation of this company. I want my money back." That doesn't indicate anything but one desire.

Mr. Fleming: If the Court please, I might briefly say this, that I don't think Mr. Palmer is in position to urge that question before this Court, because all of his clients that have appeared in this Court on the witness stand have testified that they were for reorganization, and now he is apparently representing them and fighting the problem of reorganization.

[fol. 1374] Mr. Palmer: I will ask that the remarks of counsel be stricken from the record as improper and incorrect. My clients have indicated throughout that they believe that this company could be reorganized in the state court and could not be reorganized in federal court, and our position in that has been consistent throughout. I believe the Court inquired of me personally on that and I explained it and the Court said he was satisfied with the explanation.

Mr. Fleming: I would like to refer to the record of Mr. Sims' testimony and Mr. Smith's testimony. Mr. Ross Thomas has not testified yet and I don't know what his attitude would be, but those are three clients you have, Mr. Palmer.

Mr. Palmer: That is correct. I think Mr. Sims and Mr. Smith both testified that it could not be rehabilitated as a face amount security company, and they indicated that it could be rehabilitated in the state court as an insurance company.

I would like to read this letter to the Court from John J. Rivers, Attorney at Law, May 14th, 1941, marked on it received May 15, 1941.

"Mr. Thomas J. Herbert, Attorney General and Mr. John [fol. 1375] Lilly, Superintendent of Insurance, Columbus, Ohio.

GENTLEMEN:

"This is a legal application to you as Ohio Attorney General, as Ohio Superintendent of Insurance, and as Ohio Supervisor of Bond Investment Companies by Daniel C. Rivers, a resident of Ohio, with an interest in the Ohio deposit of the Fidelity Assurance Association (Fidelity Investment Association) with a right to participate in such deposit, to file a cross petition or proper pleading in the current receivership case in the Franklin County, Ohio, Common Pleas Court, involving the insolvent Fidelity Assurance Association, or to commence a separate civil action in some court making the Fidelity Assurance Association a party to determine the right of Daniel C. Rivers and all other parties claiming an interest in said deposit to subject the deposit to the payment or satisfaction of all liabilities and to distribute such fund among the persons entitled thereto in conformance with the provisions of Ohio General Code Section 698, 699 and 641.

"Dr. Rivers' contract, 355B-175, provides for monthly [fols. 1376-1385] payments of $37.50, under which he has paid to $1875. The cash surrender value is $1450.50, and the value according to reserve on earnings indicated in the company's correspondence is $1439.40. I think that Dr. Rivers is entitled to this action on your part irrespective of the solvency or insolvency of the company, in view of the sections referred to. Here is a claim at the stipulated cash value amount which the company, by reason of insolvency, is unable to pay. He is not interested in the rehabilitation of the company, and since December 30th, 1940 has been attempting to obtain the return of his payments as indicated in his correspondence with the company.

Very truly yours, John J. Rivers."

Mr. Fleming: The debtor would like to move that this be stricken from the record. The reporter has been taking it. I don't think it is properly a part of the record.

. . . . . .

[fol. 1386] Q. Mr. Smith, in your testimony this morning some question was asked you whether daily calculations were made of the deposit requirements in the various states. I believe your testimony was that these were not made daily. Is that right?

A. That is correct.

Q. How often are they made?

A. A full inventory is made twice a year, as I recall, and in the case of several states requesting monthly reports their particular liability is calculated monthly.

Q. Did it prove to be a difficult or impossible task to supply this information monthly?

A. That is on the entire——?

Q. On the states that require a deposit?

A. No, because that involved comparatively—a comparatively small part of the records. I mean, the taking of that inventory from the records was only a small part of the total record. You see, taking an inventory is pretty much of a task. It means sorting down your individual cards into classes and different groups before you can even at-[fol. 1387] tempt to make a calculation; and where you are furnishing a liability report to states like—well, Illinois, Wisconsin and Missouri and I believe Iowa—I think one or two more; I don't recall them now——

Mr. Palmer: Will you speak up, Mr. Smith. It is impossible to hear back here.

The Witness: All right. It means you don't have to handle your whole record; just take out those particular items involved.

Mr. Jaegerman:

Q. You have no difficulty, then, in preparing the appropriate monthly reports for these states?

A. No, it is routine.

Q. And furthermore, you are able to break down those reports by series and by funds within the series?

A. Yes, we are able to do that.

Q. And didn't you do that in your basic calculations?

A. That I can't answer, because the calculation of the reserve requirements is——

Q. How about the actual deposit requirements—what you did?

A. Oh, yes, those we valued——

[fol. 1388] Q. By funds—by series, rather, and their funds within the series, and your records are so prepared——

A. Yes, information was so compiled, although, in pulling the information together in some states, we handled it not by funds but as a whole; but had it been requested by funds it would have been just as easy to do. There was, as I said this morning, I believe, one or two, perhaps three states—I know Wisconsin requested it—where we did break the deposit figures into fund groups.

Mr. Lauritzen: I would like to have you clear this up, Mr. Jaegerman. I understand he is testifying now as to a report of liabilities by funds, because he clearly testified before that the letters I showed him were typical of the letters that he sent to Wisconsin and other states which made no breakdown on deposits or securities. Do you have something contrary to that in mind?

The Court: Are you asking about liabilities?

Mr. Jaegerman: No, I am not talking about liabilities; I am talking about deposit of securities, and I thought that [fol. 1389] was the answer of the witness. Is that right, Mr. Smith?

The Witness: I was speaking of securities.

Mr. Lauritzen: If the Court please, Mr. Jaegerman's statement of what the previous answer was is not correct, because he distinctly told me they did not break them down into funds and he told me the letters I showed him were typical of letters forwarded to Wisconsin and other states.

The Court: I didn't hear Mr. Jaegerman make a statement as to what the witness said. I think maybe the witness has been a little contradictory, and you can get that on cross-examination.

The Witness: Did I answer that question?

Mr. Jaegerman: Yes, you answered my question. If Mr. Lauritzen wants to ask any questions he will do so on on cross-examination.

Mr. Lauritzen: May I have the question and answer, please?

(The question and answer were read.)

The Witness: May I qualify that?

The Court: Go ahead.

The Witness: What I was referring to was the monthly [fol. 1390] reports which were sent to these states. In other

words, a report of the liability as compared to the security deposits.

Mr. Lauritzen: May I ask a question? Mr. Smith, it is true that in Wisconsin, at least in recent months or years, you made a report each month showing the total liability in Wisconsin by funds? That is what you have just stated, isn't it?

A. Yes, sir.

Q. Do you mean to tell us that in those monthly reports you also showed in respect to the deposit of securities in Wisconsin out of the funds of which of the contract series the particular securities on deposit there had been purchased?

A. I am quite sure we prepared the information in that way.

Q. Did you send it to Wisconsin?

A. No, I don't say that I sent it. I say that I believe, and I am quite sure, that I prepared it in that way and forwarded it to the department which would make the final report. Now, whether the final report went in broken [fols. 1391-1394] down by funds, I can't answer at this moment.

. . . . . .

[fol. 1395] Mr. Jaegerman:

Q. Mr. Smith, is it not true that regardless of the increase [fol. 1396] or decrease in liability in a particular state due to cash surrenders or maturities, there were many other factors which affected the deposits and the deposit requirements of that state?

A. Yes, I think you are right.

Q. What are some of those?

A. Well, as I stated this morning, your deposit requirements in the various states differ. Some are purely statutory requirements and others are based on the market value of your deposit at a given date. Others were accepted at par.

Q. How about maturities and calls?

A. You can build up your deposit in a given reserve and you will eventually encounter settlements in the way of maturities and cash surrenders and similar settlements, which would reduce your liability within that fund; and in making those settlements you might make them out of your

current cash without disturbing your deposit in a given state. The result would be that your deposit of securities would be in excess of your requirements for that particular fund.

Q. But regardless of your cash liabilities, does a deposit remain static?

[fol. 1397] A. Well, ordinarily it should remain static, for as your liability decreased you would certainly be entitled to withdraw your excess securities.

Q. But aren't a substantial number of securities continually being called?

A. Yes, that is true.

Q. And aren't substantial numbers of securities being sold?

A. That is also true.

Q. And aren't the amounts involved in calls and sales much greater than the amounts involved in surrenders or maturities?

A. Well, I don't know whether that would hold true over a long period or not. Under normal operation, as I told you, your called bonds would closely approach your normal settlements, that is, your called bonds and maturities and—we will let it go there—your called bonds and maturities would be your most frequent means of liquidating your securities.

Q. And considering cash surrenders and maturities, is it not a fact that the cash surrenders in dollar value greatly exceed the maturities in dollar value?

[fols. 1398-1405] A. I can't answer that accurately, because I don't know. I don't have reason to go into those records.

Q. Isn't it true that certain contracts in a particular series may be cash surrendered or mature while other contracts in that same series are continuing to increase in value?

A. That is right.

Q. Any deposit released for a particular series because of a cash surrender or maturity would then be available as against contract liabilities increasing on other certificates of the same series?

A. That is correct.

Q. And wouldn't that account for a large portion of any released securities due to cash surrenders or maturities?

A. I think it would.

Q. The business that Fidelity sold was a long term business, wasn't it?

A. It was.

Q. What was the shortest maturity in any of these contracts?

A. The shortest maturity would be ten years.

* * * * * * *

[fol. 1406] HUBERT F. YOUNG called as a witness by the debtor, having been duly sworn, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name to the Court, please.

A. Hubert F. Young.

Q. Where do you live?

A. Scarsdale, New York.

Q. How long have you lived there?

A. Since June, 1932.

Q. Did you ever live in Wheeling, West Virginia?

A. No.

Q. Have you — employed by Fidelity for some time?

A. Since June, 1932.

Q. What was the character of your employment?

A. General supervision of investments of funds.

[fols. 1407-1422] Q. What business were you engaged in in 1932 before you went with Fidelity?

A. I was selling securities.

Q. Where?

A. In Washington, D. C.

Q. And since being in Fidelity's employ where have you been, that is, where have you lived or had your office——

A. Same place, New York.

Q. Then your work was handled in New York.

A. Correct.

* * * * * * *

[fol. 1423] Q. It finally compelled you to cease active business operations entirely, didn't it, in 1940?

A. I wouldn't say that did, but we could not qualify under the Investment Trust Act that was passed in 1940.

Q. By reason of that you had to cease operations late in 1940?

A. Yes, because we couldn't qualify.

Q. In your opinion, from your knowledge and experience with the operations of Fidelity and your general business experience, what is your judgment in reference to the feasibility of rehabilitating Fidelity through a proper plan of reorganization?

A. I think it could be done and should be done.

[fol. 1424] Q. Will you explain that to the Court, please.

A. Well, in my opinion there are two ways it can be done. One is by making an insurance company, mutualized; the contract holders would own the company. One other way, the only other way I know to have a face contract company, have a new company with new capital absorb the various contracts, with liabilitity on a fair bas's, to be arrived at by market value and liquidating value of the various funds; and one reason I think it should be done I think 1938 was the largest sales of any year we ever had. As I recall it, we went at the rate of fifty to sixty million dollars face value. Those people who bought then have not had an opportunity of paying long enough to get a reasonable amount of money back on their investment. I think they should be allowed to continue to pay in, on a proper basis of course.

Q. What would you think about a third possibility of merging, say with an insurance company, and continuing to write annuity contracts but also engage in business in the general insurance field?

A. Well, that would be my idea, if we had a mutual [fol. 1425] insurance company, except not to merge. I don't know what advantage we could show to some other company, just offhand, probably could—why they should merge with us.

Q. Could that be done either with a stock company or mutual company?

A. I think that could be done with either, except in a mutual company you are giving your contract holders something for giving up something. I think we all know they will have to give up something, and they should be given some kind of compensation.

Q. In other words, you feel that in working out a mutual plan that a more generous arrangement could be worked out in behalf of the contract holders than with a stock company?

A. Yes, I think the association still has a tremendous lot of good will that is available, and if it was a mutual insurance company we would have many contract holders, and if they were participating in the profits it would throw a lot of business to it.

Q. Mr. Sims testified that during the time you were with the company the assets of the company increased [fol. 1426] approximately four million dollars—more than four million dollars—that prior to that time they were apparently considerably insolvent, that is, he thought they were, and since you had been with the company the assets of the company made that much gain.

A. You mean depreciation?

Q. Appreciation.

A. Yes, sir. I think that figure is about right, but I will say this, that I came there at a time when their port folio was depreciated about forty per cent.

Q. You came in 1932, right at the bottom of the depression.

A. Right at the bottom.

Q. When securities had less value than they probably ever had at any time during the history of our country.

A. That is correct.

Q. In 1937 Mr. Sims testified that the company, by reason of appreciation in the value of the port folio, became solvent.

A. It was solvent if you threw all accounts into one hopper. I think in 1937 the income account was insolvent; the B account was, of course, solvent; but throwing them [fol. 1427] altogether there was a surplus on market values. That lasted until that drastic break in the market in June, I guess it was, of '37. In the spring of 1937 it was entirely solvent, I thought, based on market values.

Q. But notwithstanding the break in the market in 1938, Fidelity probably did the largest amount of business it had ever done.

A. Yes, I think it did the largest business it had ever done.

Q. In other words, is it during periods of depression when people are attracted to contracts of the character sold by Fidelity?

A. Yes, I think a great many people were sure in their judgment and were convinced it was a good vehicle, because

it was diversification, and when they bought one of these contracts, they had part ownership in the whole port folio in that series.

Q. Are you familiar with the fact that in 1939 Judge Baker, in the Northern District, found that Fidelity was solvent at that time?

A. Yes, sir.

[fols. 1428-1429] Q. And has there been any appreciable change in the assets of Fidelity from 1939 to the present time?

A. I would say not an appreciable gain on a percentage basis, no.

Q. As a matter of fact, there has been considerable appreciation in the past two months, hasn't there, in the value of the securities in the port folio?

A. Yes, in certain categories, for instance, railroad bonds.

Q. What do you think about the possibility or probability of appreciation in the value of securities during the next two or three years ahead of us?

A. I think we have an excellent change of appreciation on the type of port folio we have, which consists largely of, you might say semi-speculative bonds and not a great many of the higher grade bonds, which can, I think, go down quite a bit.

[fol. 1430] Mr. Fleming:

Q. I will ask you particularly whether any of those letters were in reference to the segregation of securities deposited with the various states into the proper funds as contracted by Fidelity under their contracts which were being sold in those states or had been sold in those states?

[fol. 1431] A. Well, I have a definite recollection on one particular case.

Q. What case is that?

A. That was in Illinois.

Q. I think that letter is already in the record. Just what happened in reference to that, do you remember?

A. Why, yes. When we set up the Series B, the securities were supposed to have been kept separate physically, which I endeavored to do in Illinois by writing and asking them to do it. I received a letter back which said that Secretary of State Hughes refused to separate the securities held on the various series of contracts.

Q. Did you have some experience with Wisconsin?

Mr. Gray: Is that letter available?

Mr. Fleming: Yes, it is in evidence.

Read the question, please.

(The question was read.)

Q. (Continuing:) In this same field?

A. Yes. I don't recall whether we had much correspondence or not, but I had a meeting with them at one time in Wheeling.

[fol. 1432] Q. When was that?

A. That was in the spring of '39, at the same time——

Q. Was that subject discussed in that meeting?

A. It was discussed.

Q. Do you remember what was said about that, in substance?

A. Well, the figures were produced, as I recall it, showing our liabilities in various accounts and our deposits in various accounts, and I was requested as expediently as possible to try to balance the deposits with the liabilities.

Q. In other words, I understand Wisconsin made a very good effort to comply with the contractual obligations which Fidelity had in contracts with the contract holders?

A. Yes, sir.

Q. Did you have any experience with Tennessee?

A. (Referring to papers.) With Tennessee I don't recall any specific instances with reference to accounts.

Q. Do you remember any other states outside of Wiscon-

[fol. 1433] sin and Illinois?

A. No, I don't recall any.

Q. What about Missouri?

A. Well, Missouri has always been practically balanced. I don't think we ever had a discussion on it.

Q. Generally how did you distribute these securities which were transmitted by you for deposit to the various states under their respective state laws?

A. We always asked the states to approve the deposit before making the shipment.

Q. Was there any reference to the allocation of these deposits to any specific contract fund?

A. No, not until recent dates.

Q. All right. And now, from 1932 up until say—when? 1939?

A. '38 or '39.

Q. '38 or '39. You transmitted the securities for deposit in the various states, as required by them under their state statutes, without reference to segregation?

A. That is correct.

Q. (Continuing:) Of these securities to specific contract [fols. 1434-1439] funds. Is that right?

A. That is correct.

Q. But since 1938 you have made an effort to accomplish that, have you?

A. Yes, we have.

. . . . . .

[fol. 1440] Mr. Reinhardt:

Q. Well, will you describe your understanding of the fund theory and then explain the dealings the company had with the states with respect to that.

A. I think I know what you refer to as the fund theory. That is each separate series in a separate fund on our books, and it is kept that way, of course, except with the states, say West Virginia, for instance, which has a central depository, we always advised, and I think ever since we have been here, what accounts they are coming out of, because they covered the whole country. In Illinois we attempted to segregate the securities and the state advised that they would not do that, and so they were deposited for several years there just as one general fund rather than by each individual fund.

Q. In your discussion will you please try to indicate [fol. 1441] dates, as nearly as you can fix them?

A. Well, in Illinois I wrote the Treasurer in 1935 and requested segregation, and I was advised that the Secretary of State——

Mr. Gray: If those letters are available I would prefer that they would be admitted instead of the gentleman's conclusions about them.

Mr. Reinhardt: Have you a copy of the letter that you just referred to?

A. That I wrote, yes.

Q. Is this a copy of that letter?

A. That is a copy of that letter.

Mr. Reinhardt: I ask that that be marked as an exhibit.

Exhibit 60

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer this letter in evidence as Exhibit 60.

Mr. Gray: No objection.

Exhibit 60

The paper referred to, having been previously marked as above indicated, was admitted in evidence. The same [fol. 1442] is attached hereto as a part hereof.

Mr. Reinhardt:

Q. Will you tell the Court what the reply was that you received to that letter, or do you have the reply?

A. I do not seem to have it in my files, but the reply was that they were instructed not to segregate by the Secretary of State.

Mr. Gray: Unless the letter is properly accounted for, I don't believe the conclusion of this witness would be proper.

The Witness: I did have it.

Mr. Reinhardt:

Q. Mr. Young, I show you debtor's Exhibit 59 and ask you whether that is the letter that was received in reply to Exhibit 60?

A. That is.

Q. Would you be good enough to read the relevant portions of Exhibit 60 and Exhibit 59?

A. Exhibit 60—this is a letter written by myself to the Treasurer of the State of Illinois in which I listed a shipment being made of $50,000 and detailed the bonds. Under our regular account, two thousand Pure Oil Company fifteen year Sinking Fund Notes 4½, 1950. Then I listed under [fol. 1443] special Series B account $33,000 Pure Oil Company fifteen year Sinking Fund Notes 4½, 1950, and same description, $15,000 Edison Electric Illuminating Company of Boston, First A 3½, 1965. Listing them I wrote:

"You will please note that $48,000 of these bonds are in our Special Series "B" Account which is the contract we are at the present time selling in Illinois. It is necessary

that these bonds be kept physically separate from other bonds now on deposit with you. and we will appreciate your advising us that this has been done.

"Upon receipt of the above bonds, will you please ship to Central Hanover Bank & Trust Company, Madison Avenue & 42nd Street, New York, N. Y., for our account, against receipt, the $50,000 San Joaquin Light & Power Co. Unifying & Refunding 5s, 1957."

I received reply under date of August 5th, 1935, from the Treasurer. The important part is, he acknowledges receipt of these securities I listed. Then he has this paragraph.

"We have been instructed by Honorable Edward J. [fols. 1444-1445] Hughes, Secretary of State, to issue one receipt for the $35,000 Pure Oil Company Bonds, as they intend to have only one account.

"In compliance with your request" we are shipping the others back.

. . . . . .

[fol. 1446] Mr. Reinhardt: Mr. Young, I show you a copy of a letter dated June 13th, 1939, and ask you whether that [fol. 1447] is a copy of a letter sent by you to Mr. John L. Lloyd, Commissioner of Insurance for the State of Ohio?

A. It is.

Mr. Reinhardt: I ask that that be marked, Your Honor.

Exhibit 61

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer that in evidence as Exhibit 61.

Exhibit 61

The paper referred to, having been previously marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Reinhardt:

Q. Do you have the reply that you received to this letter, if you received a reply?

A. I don't recall having received a reply.

Q. Now, Mr. Young, will you continue with your general statement on this subject?

A. Well, I was on the deposit in the State of Illinois. Up till the fall of '38 we were required to keep on deposit

with them securities with a value equal to our liability since [fol. 1448] July 7th, 1931. In the year '38 other legislation was passed making it retroactive, where we were required to bring our deposit up to the full extent of our liability, which was practically impossible for us to do, for the securities sold before that date in the State of Illinois were largely annuity contract bonds. We were trying to raise new capital at that time and we wanted to keep the state open for business, and the officials were cooperative—they said, "Well, if you will deposit another $50,000 on your prior to July 7th, 1931, you can continue to sell for thirty days more or sixty and see if you can pull your losses up." After that was done, naturally those securities had to be the ones we had earmarked for the annuity account, and they requested then that we did segregate, and when I wanted to make withdrawals or substitutions I was told then they wanted to segregate their accounts, while under the previous instructions they positively would not segregate them.

The Court: Mr. Young, explain why it was that you found it impossible to make the deposits to cover the annuity contracts.

A. Because we had them in other states who would [fol. 1449] not let us withdraw them, for instance, in West Virginia. We had to keep certain securities down here, and the Auditor of West Virginia, or the particular officer in any state, would hardly let you withdraw from that state to put them in another state, and we were short that much. The annuity account, of course, is one of the insolvent accounts, and there was simply not enough securities to go around.

Mr. Jaegerman: Would the decline in the market value of securities in your income and annuity account have something to do with your lack of sufficient deposit?

A. Oh, sure; if we could have done it on book value instead of market value it would have been all right.

Q. So it was the requirement of market value by the states, plus your shrinkage that made it impossible to cover the deposit?

A. That is correct.

Mr. Reinhardt:

Q. When was it that Illinois indicated to you this reversal in feeling?

A. The first time I recalled—this spring—recall having [fol. 1450] anything before this letter, March 14th, 1941—I don't think there was anything before that.

Mr. Reinhardt: I ask to have this letter marked as an exhibit.

Exhibit 62

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer it in evidence as Exhibit 62.

Exhibit 62

The paper referred to, having been heretofore marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Q. Will you read the relevant portions of that letter?

A. "I note your request for the transfer of certain securities from those now securing the liability on contracts sold since July 7, 1931, to the former account. The Department would prefer not to make any change in the deposits as they now stand other than your regular withdrawals and substitutions.

"At the time the original deposits of securities were made to secure the liability on contracts sold before July 7, 1931, [fol. 1451] a separate record of such deposits was made and the list given in my letter of March 1, 1941."

That is the pertinent part—which he segregated into that account.

Q. Now will you continue your statement?

A. Well, that covers the State of Illinois from my standpoint, as far as the substitutions, and in Wisconsin I made one statement—I had a conference with one or two of their officials in Wheeling in the spring of approximately '39 in which they asked that we bring the accounts into balance, which we have attempted to do.

Q. When you say "bring the accounts into balance" what do you mean?

A. By funds, having the securities in one fund in one state equal to the liabilities of the same fund in the same state.

Q. Is there any other correspondence that you had with Wisconsin which you regard as relevant to this controversy?

A. Only to the fact that they knew that we did have the various accounts, and they did know that they were not entirely balanced. I have a statement here of January 31, [fol. 1452] 1941, showing the liabilities of each account. We have a letter of February 21st pertaining to it.

Q. I show you a telegram dated February 20th, 1941 addressed to you by Frank H. Bixby, Commissioner, sent from Madison, Wisconsin, and ask you whether that is a telegram that you received from the officials in the State of Wisconsin charged with the administration of the Wisconsin deposit?

A. It is.

Mr. Reinhardt: I ask that that be marked.

Exhibit 63

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer that in evidence as Exhibit 63.

Exhibit 63

The paper referred to, having heretofore been marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Reinhardt: Your Honor, I think it would be simpler if we introduced this whole batch of letters from Wisconsin as one exhibit.

The Court: I see no objection to that.

[fol. 1453] Mr. Reinhardt: They all speak for themselves and require no particular discussion.

Mr. Gray: May I interrogate this witness while they are examining those papers?

The Court: Yes.

Mr. Gray: Did you reply to Secretary Hughes' letter that you have marked here number fifty-nine?

A. I don't remember just which number fifty-nine is.

Q. That is the one that you say that he didn't reply to your request for segregation?

A. No, I don't recall a reply to that letter.

Q. Did you make a reply to that one in 1941 in March?

A. I am not sure. (Witness refers to paper.) I don't recall it and I don't seem to have a copy.

Q. That ends the correspondence so far as you know, about it?

A. From my memory, yes.

Q. Do you have charge of procuring authority to transact business in the several states, or some of them?

A. No.

[fol. 1454] Q. Just what were your duties with reference to contacts with sister states?

A. My only duties at all was handling the securities.

Q. What?

A. Only handling and depositing and withdrawing of securities.

* * * * * * *

[fol. 1455] Mr. Reinhardt: I am offering in evidence a series of letters that passed between Mr. Young and officials of the State of Wisconsin, and ask that those be marked as one exhibit.

Exhibit 64

The papers referred to were admitted in evidence, marked Exhibit 64a, Exhibit 64b, Exhibit 64c and Exhibit 64d. The same are attached hereto as a part hereof.

Mr. Reinhardt: This exhibit consists of four letters, marked respectively a, b, c, and d, a being one page, dated February 13, 1941, b being two pages dated February 21, [fol. 1456] 1941, c being two pages dated February 28, 1941 and d being one page dated March 3, 1941.

Q. Mr. Young, do you have any reports furnished to you by officials of the State of Wisconsin or furnished by you to officials of the State of Wisconsin——

A. Yes, sir, I have both.

Q. (continuing): In which the securities deposited with the State of Wisconsin are segregated according to funds?

A. Yes, sir. This was furnished me by the Examiner for the State Banking Department of Wisconsin.

Q. On what date?

A. Market values as of January 27, 1940.

Q. Do you recall when that was furnished to you?

A. No, I don't remember the date on that, but I presume shortly after the computations were made on market values.

Q. In other words, you received that around January 27, 1940?

A. Yes.

Q. Or shortly thereafter?

A. I would say shortly thereafter.

Mr. Reinhardt: I ask that that be marked, Your [fol. 1457] Honor.

Exhibit 65

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer that in evidence as Exhibit 65.

Exhibit 65

The paper referred to was admitted in evidence, having been previously marked as above indicated. The same is attached hereto as a part hereof.

Q. Have you a statement that was furnished by you to an official of the State of Wisconsin indicating a segregation of securities by firms?

A. Yes, that was furnished them monthly. I happen to have one copy with me, but every month that was worked up at Wheeling, and copies sent to the proper officials and then it would come to my office.

Q. How long did that practice continue?

A. We always kept them advised. Whether we did it monthly up till about three years ago I am not sure.

Q. Your recollection is that it goes back at least three years?

A. Yes, I am positive of that.

[fol. 1458] Q. And it may have gone back beyond that?

A. It may have gone back beyond that.

Q. This particular one is dated February 28, 1941?

A. That is correct.

Mr. Reinhardt: I ask that that be marked.

Exhibit 66

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer that in evidence as Exhibit 66.

Exhibit 66

The paper referred to, having been heretofore marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Reinhardt:

Q. Is this Exhibit 66 typical of the reports that were furnished monthly to the State of Wisconsin during the last three years and perhaps even earlier than that?

A. Yes, it is a typical statement.

Q. Were similar reports furnished to other states in which deposits were maintained by Fidelity?

A. Yes.

Q. Can you tell us to what other states reports of this [fol. 1459] kind were furnished?

A. To Missouri, Illinois, Alabama and I think Tennessee.

Q. Were there any other states to which such reports were furnished either periodically or at any particular time?

A. Yes, they were furnished after the annual audit each year.

Q. To which state were they furnished yearly?

A. I would presume all of them. That was not under my supervision, but I would presume that it was furnished to all states.

Mr. Reinhardt: I think that concludes my examination on that, Your Honor. It might be that the states would want to cross examine on that particular point immediately, before Mr. Jaegerman goes into the matters mentioned by Your Honor.

The Court: All right, if you care to do that, gentlemen.

Mr. Lauritzen: Do you mean on the letters and reports? Yes, if the Court would permit.

[fol. 1460] Cross-examination.

By Mr. Lauritzen:

Q. Mr. Young, calling your attention to Exhibit 61, a copy of a letter written by you to John Lloyd, Commissioner of Insurance of Ohio, in which you inform him that you have recently purchased for your Series D account approximately a hundred thousand FHA mortgages with a view of depositing them with Ohio, can you tell us whether or not those mortgages were deposited with Ohio?

A. No, I couldn't. It has been quite a while and I don't remember whether they were or not. I don't think we concluded—as I recall it, I don't think we concluded the pur-

chase of the hundred thousand. We bought some, but I don't think it ran to that figure, in my memory.

Q. Where you made deposits in Ohio, did you make deposits by particular funds?

A. Yes, in that case I called it to Series D account. That was the series we were selling in Ohio.

Q. But you don't know what happened after the actual deposit?

A. No, I wouldn't recall whether I sent the whole hundred [fol. 1461] thousand or not.

Q. Or if you had sent this one hundred thousand you don't know what liabilities in Ohio would have been secured?

A. Yes, Series D; I am sure of that. As I state in the letter, they were purchased with Series D money.

Q. Mr. Young, you testified that some of the Wisconsin authorities came out to Wheeling in the spring of 1939.

A. Yes.

Q. Do you know just who that was?

A. No, I don't recall the names. It was at the time of the receivership, and there was quite a few people down there.

Q. That was the time when state authorities generally were becoming concerned over the affairs of Fidelity in the respective states?

A. That was the time of the receivership here before Judge Baker.

Q. And did a number of states become concerned over Fidelity's dealings in those states and come down to Wheeling to make inquiries as to the status of the company? [fol. 1462] A. I think several states had representatives down there at that time.

Q. And Wisconsin was one of them?

A. Yes.

Q. Do you know whether that was the first time that anyone from Wisconsin was informed as to how you kept your books, that you kept them by funds?

A. No, I don't think so. They have had access to our records for years, and as I understand it they often had—I say often—every year a representative down there.

Q. Can you tell me whether any representative from Wisconsin prior to the spring of 1939 ever examined or looked at the books of Fidelity with respect to the segregation of liabilities by funds?

A. No, I could not answer that, because I was not in Wheeling.

Q. Isn't it your recollection that in 1939 was the first time anyone in Wisconsin really had any insight into the operation of Fidelity by funds?

A. I wouldn't think so.

Q. I am just asking you if you recall.

[fol. 1463] A. No, they had access to the records and they had representatives down. I should think they knew.

Q. Prior to that time nobody from Wisconsin ever asked you to inform them as to where securities came from or to make any segregation? Am I correct in that?

A. Yes, I don't recall anything before that.

Q. Late in 1940 and early in '41, the State of Wisconsin became quite insistent with respect to the fact that you should get your funds segregated out there? Isn't that correct?

A. Yes, sir.

Q. And during all that time you continued to send securities out to Wisconsin to maintain your deposits there, didn't you?

A. Correct, sir.

Q. And the securities which you would send to Wisconsin were sent in such amounts as would make the total liabilities in Wisconsin not more than ninety per cent of the total securities on deposit in Wisconsin? Isn't that correct?

A. That is correct.

Q. Without regard to funds?

[fol. 1464] A. Without regard to funds, except we did show you the funds the securities went in.

Q. Yes. Now, if you will just answer my question.

A. Well, yes. We kept a liability—I mean our deposits, the market values, up to your requirements.

Q. And that was based upon the fact that the total liabilities on all contracts of whatever series in Wisconsin should not exceed ninety per cent of the total securities on deposit in Wisconsin, whatever their origin.

A. That is correct.

The Court: That is not exactly a correct statement, Mr. Lauritzen, because one hundred and ten per cent of a hundred is a little different from a comparison between a hundred and ninety.

Mr. Lauritzen: The one hundred and ten per cent, Your Honor, is not quite the correct way of expressing it. The actual law is that the liability should not exceed ninety per cent of the amount of the deposit.

Q. And before 1939 and after 1939 you had always sent and continued to send securities to be deposited in Wisconsin on that basis, did you not?

[fol. 1465] A. Yes, to keep the deposit up with the liabilities.

Q. Without regard to segregation of funds.

A. I wouldn't say without regard to segregation of funds, no.

Q. Now you are getting away from my question. I want you to be very definite there. The securities that you sent to Wisconsin were sent out there to keep that deposit in the status so that the total liabilities in Wisconsin on all funds would not exceed ninety per cent of the total deposits in Wisconsin on all funds? Is that not correct?

A. That is correct.

Mr. Lauritzen: All right, sir.

The Court: Let me ask you this. Did you undertake to keep each fund supplied with a hundred per cent for each ninety per cent of liabilities in that fund?

A. Only in a rough way, I would say, because till the computation was made we never knew just what the liability in any fund was in any state and quite often that was sixty days late before it was computed.

Q. Then you tried to keep the separate funds supplied up to the ninety per cent figure?

[fol. 1466] A. Yes.

Q. But as to the surplus that might be in any one fund or might be spread over the whole thing?

A. That is correct.

The Court: That seems to be what he is driving at.

Mr. Lauritzen: I don't think so, Your Honor.

Q. Isn't it a fact, Mr. Young, that before 1939 and after 1939, if you would go and analyze the Wisconsin securities fund by fund, you would find some funds would have a tremendous excess, maybe a million dollars, and some a deficit of two or three hundred thousand dollars? Isn't that correct?

A. That is correct.

Q. But what you did was to maintain in Wisconsin a deposit so that all liabilities of all funds in Wisconsin would

not exceed ninety per cent of all deposits of securities from whatever fund they came?

A. That is correct.

Q. Mr. Young, we had a telegram introduced in evidence here, Exhibit 63, dated February 20, 1941, in which Wisconsin again requested you to allocate your deposit by funds. Did you do it?

[fol. 1467] A. To the extent we were in position to do it.

Q. After that time, when you sent funds out to Wisconsin for deposit on the basis which your have testified you sent them, did you state to the authorities of Wisconsin that those securities came from any particular fund or was to be deposited as security for any particular series?

A. I am not positive whether I did or not.

Q. Now let me show you a letter dated March 24, 1941, signed by yourself, apparently written from your office at 40 Wall Street, New York, addressed to the Banking Commissioner of Wisconsin, and will you tell us whether that is the letter you wrote to the Banking Commissioner of Wisconsin?

A. It is.

Q. And tell us what the purpose of that—how did it come to be written. What were the circumstances?

A. Well, we needed an additional deposit and were requested by the authorities to make such deposit.

Q. And did they say that that deposit was requested for any particular series?

A. I would say not, from memory.

[fol. 1468] Q. And that letter there just says that you are sending them $50,000 worth of securities, doesn't it?

A. That is correct.

Q. And it doesn't say where they came from, does it?

A. No.

Q. And isn't that letter precisely the same type of letter that you always sent to Wisconsin before 1939 and after 1939 in connection with sending the securities out to Wisconsin for deposit?

A. It probably is. I don't recall for sure if they were all alike or not.

Q. Do you know that you ever, on any one occasion, when you sent securities out to Wisconsin for deposit, stated to the authorities of Wisconsin that those securities were securities of any particular Series contract fund?

A. I don't think I did.

Q. Now, there came a time when Wisconsin did find out with respect to securities already deposited from what funds those securities came, did they not?

A. Yes.

[fol. 1469] Q. At lease, you supplied them with information in that regard?

A. Yes.

Q. And that was when you commenced to make these monthly reports, was it?

A. Yes. They had been made quite a little while.

Q. Monthly reports have not been made for over two years, have they?

A. I would say about three years.

Q. About three?

A. Yes.

Q. Since 1939, let's say?

A. I think that is right.

Q. Spring of 1939 when those men from the Banking Commission of Wisconsin came down to Wheeling and talked to you?

A. I am not sure whether they were made before then or not. I didn't have that under my supervision; I don't know.

Q. Did Mr. McNulty make the monthly reports?

A. He handled them all. I don't know who did the physical work.

[fol. 1470] Mr. Lauritzen: You are having those bound, aren't you, Mr. Smith?

Mr. H. Isaiah Smith: Mr. McNulty will be here tomorrow. He will bring them.

Mr. Lauritzen: In 1938 the Banking Commission of Wisconsin conducted an investigation of the Fidelity Investment Association, didn't they, in December, 1938 and maybe extending a little bit into 1939?

A. I am not familiar with that. If it was done it was done in Wheeling in the spring of 1939. I was there.

Q. No, I am thinking of a time when the Manking Commissioner of Wisconsin subpoenaed contract holders and officers of Fidelity in December, 1938.

A. That was just rumor, as far as I was concerned.

Q. You didn't attend any hearings?

A. No.

Q. Do you know who, with the company, is most familiar with those proceedings?

A. I would say Mr. Risley or Mr. McNulty.

Mr. Lauritzen: I would like to have this letter of March 24, 1941, marked if you please.

[fol. 1471] Exhibit 67

The paper referred to was marked as above indicated.

Q. You have identified this letter dated March 24, 1941, addressed by you to the Banking Commissioner of Wisconsin, and we now offer this as Exhibit 67, and that letter is the same kind of letter that you always sent relative to securities deposits?

A. Yes, sir.

Q. And does that hold true for other states than Wisconsin?

A. Yes, they were all just about the same.

Q. In sending securities to any of the states, be it Wisconsin, Illinois, Tennessee, Ohio, Maryland or the rest of them, you never designated the source of those securities with respect to funds?

A. Yes, to some of them, like this one to Ohio a while ago, the Series D fund.

Q. That is one instance. Do you know of any other instance?

A. I wouldn't say I know of them, but I would say there are other instances.

(Witness examines papers.)

[fol. 1472] Q. Do you want to look those over and see if you can reply to the last question?

The Witness: Read the question.

(The question was read.)

A. Yes, Exhibit 60 covered it.

Q. The Illinois letter?

A. The Illinois; and yes again, 64, to Wisconsin.

Q. Isn't it true, Mr. Young, that Exhibit 64 is a statement relative to securities already on deposit with Wisconsin?

A. That is an exchange. I was asking to withdraw the bonds and substitute other bonds in their place.

Q. But the bonds you were substituting in their place, when you sent them out you didn't tell them from what fund they came, did you?

A. (Referring to papers): Well, in your letter here——

Q. You are referring to exhibit number—it is the letter from Mr. Bixby under date of February 28, 1941, addressed to Fidelity Assurance Association for your attention?

A. Yes.

[fol. 1473] Q. All right. What does it say?

A. "At the time we sent you our telegram we stated that we expected the new securities to be received would be allocated to their proper accounts. From your letter of February 21 it appears that this matter of adjustment of the various balances due to the various trust accounts will take considerable time before they are completed."

Q. Will you just read on there?

A. "You ask in your letter if it would be permissible for you to withdraw the excess amount in one account so that this balance could be used in withdrawing securities from other state depositories and then redepositing them in this state to the proper accounts." That was the part I brought out a while ago.

Q. Just read on, please.

A. "I am wondering if it is your intention that when you withdraw this surplus balance from the income reserve account that you will substitute sufficient securities so that the total amount of your deposits now on deposit with this state will not change, as we must at all times maintain the margin [fol. 1474] required by law. It was our understanding, in the letter received from the home office, that this matter of adjustment of various trust accounts would have been completed prior to this date."

Q. So what you did, after the substitution was made, was to send out securities in the same old way, wasn't it, without designating where they came from?

A. No, I think we designated in some instances. I don't recall it. That is pretty far back.

Q. What is the date of that letter you were just reading from?

A. February 28th.

Q. And then here is a letter of March 24th. Don't you suppose that was the deposit made in accordance——

A. I am sure in all instances it was not designated. I think in some it probably was.

Q. You have named two instances, one in a letter to Ohio, one in a certain letter to Illinois?

A. Yes.

Q. You don't know of any instance where it was designated to Wisconsin, do you?

A. Not offhand, no sir. I would have to go through my [fol. 1475] letters; I just don't remember that.

Q. Do you think there were such instances?

A. I think there were such instances.

Q. If you think so, will you look through your records and ascertain for us definitely in that regard?

A. That information will be here in the morning. I would rather see it before hazarding a guess at it.

Q. Mr. Young, I have been asked to inquire of you with respect to this Ohio letter Exhibit 61 whether you don't know it is a fact that you never sent any of those FHA mortgages that you mentioned there to the authorities in Ohio?

A. No, I don't know it is the fact.

Q. You don't know the answer one way or the other?

A. No, I don't recall whether they were sent there or not. It might have been sent to West Virginia.

Mr. Lauritzen: I think I have concluded my examination on these letters. I presume that is all we should cross examine on at this time.

Cross-examination (resumed.)

By Mr. Reinhardt:

Q. Mr. Young, within the limitations of the Wisconsin [fol. 1476] ninety per cent law, what efforts, if any, did you make to allocate Wisconsin deposits by funds?

A. As the money came in from our contract holders, as far as you could in a rough way—For instance, we knew we were not selling the annuity contracts in Wisconsin for a good many years; we were selling the B and A; and as far as practicable we deposited to those two accounts, but not exactly to ninety per cent. That was a figure we would shoot at, but it was sometimes impossible to keep them allocated that way.

Mr. Reinhardt: That is all on this question, Your Honor.

Mr. Lauritzen: Mr. Young, as a matter of fact, you never

got to first base with respect to allocating any funds to Wisconsin by series, did you?

A. Oh, yes.

Q. Don't you know in one series there is a million dollars overplus and in another series some hundreds of thousands of dollars deficiency?

A. Not that much.

Q. You just testified to that a while ago.

A. In Wisconsin?

[fol. 1477] Q. Yes.

A. A million dollars over in one account? Let's see it. We have that right here.

Mr. Ray: It was filed in an exhibit yesterday right here (handing paper to Mr. Lauritzen).

Mr. Lauritzen: Oh, yes. Here we are, Exhibit 55, Mr. Young, apparently reflects the securities deposited and the net cash liability in Wisconsin by funds as of June 6, 1941. If you will look at this you will see that each of the funds is out of balance.

A. Yes, nothing like a million dollars, though.

Q. I understand.

A. For illustration, take our B fund. The market value of securities was $1,577,000, the liability $1,530,000. On the BMR the market value was $287,000 against $221,000. In the annuity account it is short, a market value of $242,000 against $373,000; and the A account was over. Some of them have to be over or you cannot put the amount required to deposit up there.

Q. In other words, in operating under Wisconsin, you just couldn't keep allocated as to funds and still obey the Wisconsin law, could you?

[fol. 1478] A. No, you couldn't do it.

Mr. Lauritzen: All right, sir.

The Witness: No, I wouldn't say you couldn't do that, either, no.

Mr. Huwe: May I ask a question, Your Honor?

The Court: Yes.

Cross-examination.

By Mr. Huwe:

Q. Mr. Young, can you tell us how often you completely changed or substituted securities in Wisconsin or any particular state?

A. There is no certain time; it depends on market values and requirements.

Q. Would you say that you would during a period of three years completely substitute the character?

A. Oh, no.

Q. It would take longer time than that?

A. Take longer time.

Q. When these respective state examiners and officials would come to Wheeling, would they be shown the separate trust fund accounts, and were they aware and did they have notice during the duration of those accounts that they [fol. 1479] were separate trust fund accounts?

A. I couldn't answer that, for I was never in Wheeling when they came.

Q. In your conferences and correspondence with them over the period of time that you were connected with the company, did they evidence a knowledge that there were such trust funds as A, B, C, D, etc.

A. Yes, sir.

Mr. Lauritzen: We object to the use of the term "trust funds" unless you tell us how you are using it and whether you are using it in a legal sense.

The Court: Overruled. That is the term you used in your correspondence.

Mr. Lauritzen: No, sir.

The Court: Well, that is in your telegram.

Mr. Lauritzen: No, sir, I don't believe we used the term "trust funds".

The Court: Look at that telegram and see if he didn't.

Mr. Lauritzen: The Court is correct; "be segregated to individual trust funds in accordance with paragraph four." I am sorry, Your Honor.

[fol. 1480] (The question and answer were read.)

A. I believe all states knew that, for the reason that we qualified in a certain state to sell a certain series, and that state had to be cognizant of the fact that we were selling a different series. For instance, if we were selling A in Illinois, before we could sell B we had to qualify for a different series entirely. I feel the states had knowledge of that.

Mr. Huwe:

Q. So that these respective state officials accepted these securities knowing that they were coming from specific trust funds?

A. I should think so.

Mr. Lauritzen: Now, if the Court please, that is directly contrary to the testimony that Mr. Young has already given He testified time and again that when he sent out the securities, in only two instances that he could name did he ever tell them from what source they came.

Mr. Huwe: When he sends out a letter it is no indication that they don't know those securities are coming from a particular fund. The fact that he doesn't say they are coming from this fund doesn't relieve them of the knowl- [fol. 1481] edge that they are coming from a specific fund.

Mr. Lauritzen: How on earth can they know when all they get is a letter from Mr. Young and some negotiable securities?

The Court: That wasn't all they got. They got reports from time to time; they sent their men down and looked at the books.

Mr. Lauritzen: After the deposits were made, Your Honor, but when the securities came out no one knew where they came from—no one could know.

The Court: Is there a distinction made here now between knowledge at the time they were deposited and knowledge later on?

Mr. Lauritzen: I think that is Mr. Huwe's question.

Mr. Huwe: My question is directed with charging the state officers with knowledge that there are separate trust funds, and when they get a security it is coming from some trust fund, and therefore they are charged with knowledge that the securities belonged to certain funds, although they don't know specifically what fund it is.

[fol. 1482] Mr. Farmer: If the Court please, I object to the generality of counsel's question. If he is trying to show that somebody in particular knew, I think he ought to frame his question in such way as to find out who knew and when he knew, but just to say these states knew, that is not a proper question.

Mr. Huwe: I said "state officials", Mr. Farmer.

The Court: The Court will interpret the evidence in the light of the other facts adduced. I am going to overrule the objection.

Mr. Huwe: I think you have answered that question. There is only one other question. Were you in Wheeling in the spring of '39 when there was a parade of investigators from the various states coming into Wheeling?

A. Yes.

Q. And were you present when some of those investigators or most of them were examining the books?

A. Yes.

Q. Were those men shown in your presence, a separate port folio for each separate fund?

A. I know—I am not sure of the detail they got, but in my conferences with them I know, especially with Wiscon- [fol. 1483] sin, we went over the funds and talked of that very thing, maybe not the individual securities, but whether there was a million dollars liability and a million and a quarter assets or vice versa. That was discussed explicitly.

Q. So that at least the Wisconsin investigator and those others that were present—do you remember what other states were present at that time?

A. No, I don't. As you said, there was a parade.

Q. At least those officers knew that there were separate trust funds and securities belonging to separate trust funds, and that the cash payments were put into such port folios and separately held?

A. Correct.

Q. You were not present at earlier investigations of that type?

A. No, I was not.

Q. But you do know from your general relationship with these officials since '32 when you first became connected with the company, that they were aware of the existence of the different funds?

A. Yes, as I say, every time we registered a contract they [fol. 1484] had to know what that contract was.

Mr. Lauritzen: Just a moment on your last answer, Mr. Young. You told me a moment ago, didn't you, that you didn't know of anybody from the State of Wisconsin who, prior to 1939, came in and looked at the books of Fidelity

and ascertained whether or not the accounts were kept by funds or how they were kept?

A. We were talking about '39 now.

Mr. Lauritzen: Read my question.

(The question and answer were read.)

A. And would know they were a different series entirely.

Q. Since 1932 or 1939?

A. I think that has gone on ever since there has been a company.

Q. You just told me a minute ago that you didn't know, up to the time the Wisconsin men came out in the spring of 1939, that any man from Wisconsin had ever looked into Fidelity's books to find out how they were kept as to funds or any other particulars.

The Court: Mr. Lauritzen, he is explaining to you that he is basing his answer to the last question of Mr. Huwe on [fol. 1485] the fact that the contract itself says that a trust fund is set up as a reserve for that particular class of contracts. This is argumentative, of course, but nevertheless that is his testimony, that that being on the contract, and the contract exhibited to the state official, that they must have knowledge of it.

Mr. Farmer:

Q. Mr. Young, are you familiar with the descriptive booklet with respect to these Series B contracts that the company got out in 1939 or 1940?

A. I have seen it. I wouldn't say that I am especially familiar with it. Naturally I have seen it.

Q. Was that sent to these various state department officials?

A. I don't know that. I didn't handle that at all. I presume it was, but I don't know.

Q. You don't know what use was made of that?

A. Yes, I know this. Every contract holder you approached after this date must be shown the prospectus.

Q. You say every contract holder who was sold a contract of Series B must be shown this descriptive booklet?

A. It was presumed the salesman, in presenting it, would [fol. 1486] show him that booklet.

Q. It was presumed, you say?

A. Yes.

Q. Was it sent out with instructions to the salesmen to show it to them?

A. That wasn't in my department.

Q. Whose department was that?

A. That was in the sales agency division, which I had nothing to do with whatsoever.

Q. They provide a receipt for the contract holder to sign acknowledging that he has received this booklet, don't they?

A. I think so, yes.

Q. Was that prepared under the directions of the Securities and Exchange Commission after that injunction was granted in the suit in Detroit?

A. I wouldn't say it was prepared under their supervision. I think it was requested that we change our form of statement, and to that extent I am sure they had supervision of it.

Q. Do you know who handled the preparation of the booklet for your company, who worked up the figures and state-
[fol. 1487] ments that went into it?

A. I think the auditors, Haskins and Sells.

Q. And what officials of your company?

A. I don't know. That was done in Wheeling, and I am not there anyhow.

Q. Were you familiar with the fact that this balance sheet in this booklet showing the investment of the reserves of Series B contracts contained this explanation or statement, "The securities deposited with state authorities are subject to the requirements of the states with respect to all the contract funds of Fidelity Investment Association, and are not necessarily held for the sole benefit of the holders of these particular contracts. In this connection reference is made to the foreword of this report"—were you familiar with that representation that went out?

A. I don't recall it.

Mr. Ray: What is this booklet? Hadn't you better put it in evidence?

Mr. Lauritzen: I believe Mr. Isaiah Smith has arranged for a supply of these booklets to come down here tomorrow, and we can introduce it in evidence at that time.

[fol. 1488] Mr. Schurr: I have to return that to the Insurance Commissioner of the State of Missouri. I can't leave that here.

Mr. Ray: They are asking a lot of questions of this witness about a booklet the witness hasn't even seen, and which is not in evidence.

The Witness: I have seen it.

The Court: I don't believe there is any use asking questions about that. He said he doesn't know anything about it.

The Witness: I had nothing to do with compiling it whatsoever.

Mr. Farmer: Is this statement correct: "The investments of reserve funds, unmatured contracts and maturity and retirement reserve fund include securities which were transferred in 1933, 1934, 1935, and 1937 from other funds of Fidelity Investment Association at market values, which were $23,553.61 more and $1,542.31 less, respectively, than the cost when originally acquired by any of the funds." Is that statement correct?

A. I presume it is. Haskins and Sells edited it; I would presume it is correct.

[fol. 1489] Q. Did they get that from your records about the switching of these securities?

A. It went through our accounts, of course, at Wheeling. When they checked it they would have to get that; they couldn't miss it.

Q. You are familiar with that part of it?

A. Yes, sir.

Q. That related to your particular duties, didn't it?

A. Yes, sir. I don't recall the amount, but I know——

Q. And you know it is a fact that in 1933, 1934, 1935 and 1937 securities were transferred from other funds?

A. Yes.

Mr. Farmer: We want to ask some more about this after somebody gets on the stand that is more familiar with it.

Q. Did you tell me who would be the man that was most familiar with this booklet and the use that was made of it and the preparation of it and getting the approval of the SEC, and all that?

A. Well, of the present staff I would say Mr. McNulty.

[fol. 1490] Mr. Reinhardt: For the record, I want to say that the SEC did not approve this pamphlet,

Mr. Farmer: I think the witness said they did.

A. No, I didn't say that.

Mr. Farmer: I misunderstood him.

Q. You said, as I caught you, Mr. Young, that you believed that there were some statements of some sort to Tennessee officials, the Insurance Commissioner, showing some segregation of securities by these different funds?

A. Yes, sir, monthly it did. Whether each specific shipment called attention to the accounts I don't remember, but they got a monthly statement that did.

Q. The Tennessee department did?

A. Yes.

Q. Do you know that of your own knowledge?

A. No, I didn't send them out, but I had copies.

Q. Who would send them out?

A. It comes from the Wheeling office. I don't know who had the supervision of that.

Q. Who was the man who could say they were sent or not sent?

[fol. 1491] A. I would say Mr. McNulty.

Q. So you don't know of your own knowledge?

A. No.

Q. So far as you know of your own knowledge, you never told the department in Tennessee that there was any separation of any of them.

A. No, I don't think I did.

Mr. Farmer: That is all.

Cross-examination.

Mr. Reinhardt:

Q. Mr. Young, when you got copies of these monthly statements from the Wheeling office, was there any indication of the use they had been put to?

A. I don't think it indicated, but it was always understood they were gotten up for the particular purpose of informing the states. That was the reason they were compiled, so we would all be familiar with the deposits and the other information that was necessary.

Q. As to the statement in this pamphlet that there had been a transfer of securities from one fund to another, do you know what that refers to?

A. Oh, there was quite a number of transactions in that [fol. 1492] category.

Q. Were they sales from one fund to another?

A. They were sales from one account to the other, which prevented a physical transfer of the securities.

Q. You mean that these funds were so far regarded as independent entities by the company that one fund sold securities and bought securities from another fund?

A. Yes, they were always segregated that way.

Mr. Palmer: I will ask you whether you will develop that by showing whether there was actual selling and buying, or just a book transaction on Fidelity's books. I think the Court would like to know that.

Mr. Jaegerman: I think we can develop that, Your Honor, in the general history of the workings of this company.

The Court: All right.

Mr. Jaegerman: And I believe it would be easier to start with one fund and see how one fund works.

Mr. Palmer: Before you start, may I ask Mr. Young one question with reference to the examination that has gone on today?

Q. Do you know when Series B contracts were first [fol. 1493] sold?

A. 1934, I think.

Q. Up until that time had there been any segregation of funds in the various states?

A. On our records, yes.

Q. Isn't it a fact that Mr. Sims, the State Auditor of West Virginia, required you to put into your Series B contracts a provision that the moneys received by the company from the contract holders of that contract, would be held by the company separate and apart from all other funds?

A. Yes.

Q. And wasn't that the first time you had any such provision in your contract?

A. The first to my knowledge.

Mr. Palmer: I don't want to give up my right of cross-examination, but I wanted that one point in connection with this present point.

Cross-examination.

By Mr. Jaegerman:

Q. Mr. Young, that was a question of terminology and wording, was it not, and the practice of the company has

[fols. 1494-1508] been to set up this segregation according to its understanding of prior contracts.

Mr. Palmer: What does the corporation understand about the wording of contracts? Can't we speak of individuals?

Mr. Jaegerman: A corporation acts through individuals, Mr. Palmer.

The Court: Go ahead.

The Witness: I would like to have the question read.

(The question was read.)

Mr. Jaegerman: Its understanding, or as the corporation had been advised by its attorneys.

A. Yes.

* * * * * * *

[fol. 1509] Q. Now, let us take the State of Missouri, for instance. How many times a year would you receive reports that there were liabilities of the company to contract holders in Missouri and that you would be required to make a deposit of funds in Missouri?

A. As I said, for the last three years they came in monthly, as I recall it, in Missouri.

Q. How about before that?

A. It came in periodically. I don't think it came in over about twice a year, as I recall it.

Q. In the last three years——

A. Four years—three or four years.

Q. The last three or four years, did you receive a report as to the liabilities of every state monthly?

A. No, I did not.

Q. Which states did you receive monthly, or was that spasmodic?

A. I received monthly Wisconsin, Illinois, Missouri, Alabama——

Q. West Virginia?

A. I am not sure whether I got West Virginia monthly or not.

Q. Do you recall any others than those you have men-
[fol. 1510] tioned?

A. Tennessee.

Q. As to the other states in which deposits were required, how frequently or infrequently did you receive reports of the liabilities there which required deposits?

A. An average of twice a year.

Q. An average of twice a year. And that included West Virginia?

A. Yes.

Q. How frequently did you receive reports that liabilities in the various states in which there were deposits had matured and that you could ask for a withdrawal of funds?

A. I never received such a report.

Q. Who took care of the withdrawing of funds when liabilities matured?

A. Of the various states?

Q. Yes.

A. Well, in practically all cases our liabilities were increasing at the same time so there were practically no withdrawals.

Q. That is just what I want to get at. So long as you continued each year—by "you" I mean the company—to sell more contracts in amount than liabilities accrued, you [fol. 1511] didn't bother to make withdrawals, isn't that right?

A. Well, in some states we couldn't, because our deposit was deficient of the amount.

Q. My point is this, that if in a given state you had maturities of $50,000 cash value a year and liabilities of $100,000 cash value a year, your practice was merely to deposit an additional fifty thousand a year and not otherwise disturb the fund. Isn't that correct?

A. Yes, in proportion as we could; not always exact, as I said before. That was the principle.

Q. Yes, that was the principle of it. So that under that practice it was impossible for you yourself to try to determine for each series an amount that became due by maturity whereby you could have release of funds and replace that as a new deposit when new liabilities occurred? Isn't that correct?

The Witness: Read that question, please.

(The question was read.)

Mr. Ray: Your Honor, we object to the use of the word "impossible" in that question.

The Court: I will overrule the objection.

A. In that case it was not necessary for me to know the maturities, because, as I say, I was given the additional

[fol. 1512] liability and it was not of interest to me when the maturities came especially, because the cash as it came in was allocated to that particular contract or series and the cash was there for maturities. It was no interest to me how they matured; it was of interest to me what the total liability was.

Mr. Palmer:

Q. My question was that so far as you personally were concerned, it was impossible for you to determine the amount of liability that matured in a given state and have those funds released and then when a new liability was incurred, to substitute those or other funds for that. Isn't that correct?

A. No.

Mr. Jaegerman: Your Honor, may I renew the objection to that question as framed? The witness has already testified it was unnecessary for him to do that. I don't see how the question of possibility would arise.

The Court: Well, that is only a matter of opinion whether it was necessary or not. I will overrule the objection.

A. It was not impossible. All I had to do was to request Wheeling, if I wanted it, and I would have it in thirty or forty days.

[fol. 1513] Mr. Palmer:

Q. Then you could have requested Wheeling to furnish you with the amount of maturing liability in each state?

A. Certainly.

Q. Did you ever request them?

A. Yes, numbers of times.

Q. Did you request them periodically?

A. No, not periodically. I would request them when I thought it was important for me to have it.

Q. To have that information?

A. To have that information.

Q. How long did it take to obtain the information?

A. Well, it depended on how much work they had to do in the Wheeling office. I would say an average of about thirty days, as I told you before; it took about thirty days to work those reports up.

Q. Would the various state depositories when, say the maturity had arrived for contract holders in the special income series for which there had been a deposit made—when those contract holders had been paid off, would the various states release the funds to you which were deposited as security for that special income series contracts?

[fol. 1514] A. That has been done, yes.

Q. And has it been refused?

A. Not when we had sufficient on deposit. I don't think it ever has.

Q. What do you mean "when you had sufficient on deposit"?

A. When the assets equalled or exceeded the liabilities.

Q. The total of all contracts? Is that correct?

A. Yes.

Q. What I am trying to get at is this: If you had paid out certain contracts at their maturity and wanted to withdraw the deposits which had been made on your books for that particular fund with a given state, were you permitted to do so unless there was a sufficient deposit in the state whereby all liabilities were covered by the total fund on deposit?

A. Yes.

Q. You were permitted to withdraw it?

A. Yes.

Q. In what state were you?

A. By making substitutions.

[fol. 1515] Q. Oh, yes, but I say, were you permitted to withdraw it absolutely and leave that fund in its current shape although other funds might have been under?

A. Well, I don't recall attempting that except in West Virginia.

Q. You never attempted that in any state?

A. I don't recall attempting it.

Q. So that, then, you were not attempting to keep these funds in the states by series, the deposits in back of them, were you?

A. Yes, that is not—that is not the situation. The older accounts the deposit had not been sustained due to market drops for several years, so they had been under water in most of the states for quite some time, and knowing they were, we certainly would not request the state to give them up.

Q. Was that true in every state that the older series of deposit that you had on your books for it were under water?

A. I wouldn't say all of them. I don't recall just which ones, but several of the larger ones were.

Q. Well, your special income series has been maturing over the last seven or eight years, has it not?

[fol. 1516] A. Yes.

Q. And you have been paying out on it over the last seven or eight years?

A. Yes.

Q. In fact, if it had not been for re-dates, and so forth, it should have all been paid up in 1936, isn't that right?

A. I wouldn't answer that; I don't know.

Mr. Jaegerman: Your Honor, may I ask the counsel to bring out in what states special income contracts——

Mr. Palmer: You bring it out.

Mr. Jaegerman: They were only sold in West Virginia, Pennsylvania, Indiana, and the District of Columbia.

Mr. Palmer:

Q. In any of those states Mr. Jaegerman has mentioned, did you ever withdraw any funds which had been deposited as security for the special income series?

A. I don't recall. For instance, the District of Columbia, we had no deposit. In Pennsylvania, we had a very small deposit. We were required to put up a hundred thousand, as I remember, when we went in there. So there was nothing to recall.

Q. Did you recall it?

[fol. 1517] A. I say, I don't recall any.

Q. The special annuity series, has it been maturing?

A. Yes, the last few years.

Mr. Palmer: In what states was it sold? Perhaps Mr. Jaegerman can tell us.

The Witness: I haven't it before me.

Mr. Jaegerman: That was sold in Illinois, Pennsylvania, West Virginia, Ohio, Michigan, Indiana, District of Columbia, Kansas, Virginia, Maryland, Tennessee, Missouri, Oklahoma, Florida, Connecticut, Kentucky, Delaware, New Jersey, Mississippi, Minnesota, North Dakota, South Dakota, Arkansas, Iowa, North Carolina, and Alabama.

The Court: Did you get all of those, Mr. Palmer?

Mr. Palmer: Yes, sir. I am asking the witness to keep them in mind.

Q. Mr. Young, can you name any of those states in which, by virtue of having paid to a contract holder his matured contract, you so advised the depository in that state and withdrew funds because you had paid up the matured contracts?

A. Yes, we withdrew funds from Illinois.

Q. In what year?

A. '34 I think it was.

[fol. 1518] Q. Under what circumstances did you withdraw the funds?

A. Under the circumstances we had more there than was required under the special contract—annuity contract, as I recall it.

Q. Did you also have more on all of your assets than you did your liabilities?

A. In Illinois?

Q. Yes, at that time.

A. At that time we were, according to the requirements—the requirements were made July 7th, 1931 and we did have considerably more and I withdrew, as I recall it, some $300,000.

Q. And that was the reason you were permitted to withdraw it and not because you had paid up your special annuity contracts?

A. That is why we had the excess, because we had been paying up.

Q. When did the special annuity contracts first mature?

A. I couldn't answer that.

Q. Can you give me some approximate date?

A. Let me see. I would say they started maturing in '34 or '5, I think it was.

[fol. 1519] Q. And when did you first start paying up on them?

A. First learn of it?

Q. When did you first start paying on these matured contracts? In '34 or '5?

A. I think that is correct, a very small volume then. There was no large volume of matured contracts and annuities till the last three years.

Q. Then the deposit that you withdrew in 1934 in Illinois could not have been because you paid up on your special

annuity contracts, if you didn't start maturing them until '34 or '35?

A. We had cash surrenders, though.

The Court: Mr. Palmer, all this line of questions that you are propounding seems to me to be directed at a subject that is just as clear as it can be in the Court's mind without the necessity of all the questions and that is that it is plain that in states which required deposits to equal a certain percentage, a hundred per cent or one hundred and ten or whatever it might be, of all liabilities that the debtor here would not have been permitted to withdraw a surplus in a particular fund if there was a deficiency in another fund that more than equalled that surplus. That seems to me [fols. 1520-1528] to be as plain as the nose on your face without the necessity of long examination.

* * * * * * *

[fol. 1529] Q. Now, I believe you said that Fidelity tried and couldn't qualify under the Investment *Trust* Act of 1940?

A. I don't think they tried.

Q. Beg your pardon?

A. I say, to my knowledge, it was not tried.

Q. By legal investigation and financial investigation and so forth, it was determined it was impossible for them to comply?

A. It was concluded, as I understood it, that we could not comply without additional capital.

Mr. Jaegerman: Your Honor, I object to that question, because I believe the record shows Fidelity did comply with the Investment Act of 1940.

[fol. 1530] The Court: Did?

Mr. Jaegerman: Yes, they filed this notification as required by that Act.

Mr. Palmer: And it was licensed by the S. E. C.?

Mr. Jaegerman: The S. E. C. doesn't license any company.

Mr. Palmer: You mean that Fidelity was permitted under the Investment Act of 1940 to go on and operate by the S. E. C.?

Mr. Jaegerman: I believe that is true.

Mr. Farmer: If the Court please, I believe the gentleman ought to be able to make an accurate statement about that. Surely the gentleman doesn't mean what he says.

Mr. Reinhardt: I think Mr. Jaegerman means exactly what he says. I think perhaps counsel has something else in mind.

Mr. Palmer: Why not let Mr. Jaegerman say what he meant——

The Court: Let's have one at a time and proceed in an orderly way. Mr. Jaegerman, do you have a statement to make?

Mr. Jaegerman: If Mr. Palmer means that under the Act they were not permitted to make a new sale, I understand that is correct, but that certainly does not mean they were [fol. 1531] not permitted to remain in business.

Mr. Palmer: Your position is they were permitted to carry on their old business but not to engage in the business of selling annuity contracts such as they had been? Is that correct?

Mr. Jaegerman: The Act states certain requirements as to the contents of any new contract Fidelity might sell and under the terms of the Act, it couldn't sell the contract it had been selling.

Mr. Palmer: I think that is what Mr. Young and I both understood when I asked him and he told me that they couldn't comply with the Investment Act of 1940. Isn't that right, Mr. Young?

A. I said I wasn't entirely familiar with it, but we didn't think we could get a contract under it at that time that would be profitable and salable.

Q. And that is what you understood when we were talking about the compliance with the Act or failing to comply, is that correct?

A. That is correct.

Mr. Farmer: I just want to ask Mr. Jaegerman if he would state that this company never became a registered [fol. 1532] company under the Investment Act of 1940.

Mr. Jaegerman: I have already stated that it did file its notification under the Investment Company Act.

Mr. Farmer: That wasn't my question. Did it become a registered company under the Investment Act of 1940?

Mr. Jaegerman: I don't know what you mean by it becoming a registered company.

Mr. Farmer: Are you familiar with the definition of "registered Company" under that Act?

Mr. Jaegerman: Yes.

The Court: Let's see if the Court understands what happened. After the passage of the Investment Company Act of 1940, the character of the Fidelity contract as then written was such that it could not be sold in compliance with that Act?

Mr. Jaegerman: That is right, your Honor.

The Court: And therefore it had to quit selling those contracts, and that is the extent to which the Investment Company Act applied to this business?

Mr. Jaegerman: One thing further: Under the Act, if they were to use the mails in interstate commerce, they would have to file notification—that would apply to its [fol. 1533] old business—and they so filed notification.

The Court: So that it is not an opinion question yet whether or not the Fidelity Company, by producing a new form of contract which would comply with the Act, would be permitted to do business?

Mr. Jaegerman: That is right, your Honor.

The Court: All right.

Mr. Palmer:

Q. Mr. Young, did you and the others of Fidelity attempt to produce a new contract or attempt to look into whether or not a new contract could be produced by which you could make any money and which would comply with the Investment Company Act?

A. I did not. That was entirely outside of my activities.

Q. You advised with those, however, as to what financial return they could get on the type of investments they would make, did you not?

A. Yes, I did.

Q. And was it not determined, to your knowledge, that the company could not produce a contract on which they could make money at the return allowed by the Act and in the type of security in which they would have to invest?

[fol. 1534] A. No, that was not determined.

Q. What was determined?

A. It was only determined, as I understand—as I say, it was entirely out of my activities—but that the contract or the yield that we were allowed to give to the contract holder—not allowed to earn ourselves, but to give—was not sufficient to make it attractive to the purchaser and allow the necessary loading for expenses.

Q. And that still holds, doesn't it?

A. I presume so.

Q. You stated it was your opinion that while it could not, therefore, qualify under the Investment Company Act, the company could and should be rehabilitated, first that it could be rehabilitated as a mutual life insurance company, with the contract holders to become the owners of the company?

A. I did not state that in my opinion it could not register as a face amount contract company. I think changes can be made to where it could.

Q. Let's get to this question. You stated that you thought it could be rehabilitated as a mutual life insurance company?

[fol. 1535] A. In my opinion it could.

Q. And that would be where the contract holders would be the owners of it?

A. That is correct.

Q. The present stockholders would have no equity left?

A. No, none.

The Court: They haven't any now, have they, Mr. Young?

A. I would say not.

Mr. Palmer:

Q. And it would be necessary that this company qualified to do business under the life insurance laws of each state wherein it went to do business?

A. I presume it would. I am not familiar with that; I have not gone into it; I presume they would.

Q. Can you tell me whether those persons in charge of life insurance in each state are the same persons who were in charge of the annuity companies with which you did business?

A. As a general thing they are, I am sure.

Q. Now, you next said that it could be reorganized as a face amount security company with new capital, is that correct?

A. Well, I didn't—I have not prepared a plan for the reorganization of the company, but in my opinion, some-

[fol. 1536] thing on that order could be done. It could be merged with another company or absorbed by another company which has additional capital.

Q. Do you think that this particular company can be rehabilitated in itself so as to sell face amount certificates and make money in view of the Investment Company Act of 1940?

A. Yes, I think it could.

Q. And why couldn't the old company do it?

A. Because you have to make a lot of changes; you have to cut down an awful lot of expense, but it could be done.

Q. Didn't you just say that you were not able, in the old company, to make a new contract whereby you could make money and still carry the loading and still give the investors anything that would be attractive to them?

A. I am not so sure that is the case. I had nothing to do with that conclusion. I am not so sure in my mind that that is the case. Other people are doing it.

The Court: By the changes you speak of, do you refer, perhaps, to a scaling down of loading or some other feature that would render the expense of selling the contracts [fols. 1537-1538] less and thereby increase the profits?

A: I think that there would have to be a contribution made by the contract holders of the various series and especially the ones that are insolvent, and that the others should be asked to reduce the required amount presently required to redeem them.

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[fol. 1539] Q. With the exception of West Virginia, you would have to comply with state laws in every other state?

A. That we attempted to do business in, yes.

Q. And those laws are much more rigid?

A. Some of them are; some of them are not.

Q. Wisconsin is?

A. Much more rigid.

Q. Illinois is?

A. Not very much more.

Q. What others are more rigid?

(No answer.)

Q. Iowa?

A. No.

Q. New York?

A. We don't attempt to do business in New York with this company; never have. Wisconsin is the only one that

is much more severe than West Virginia laws, and I will say this—I am not sure of this, but I am of the opinion [fols. 1540-1545] that the insurance requirements in Wisconsin are not as severe as the ones we are at present operating under.

. . . . . .

[fol. 1546] Mr. Palmer:

Q. In Wisconsin there are certain liabilities to the contract holders by virtue of their contracts for payment to them of cash amounts. Is that correct?

A. As set out in their contracts.

Q. And there are sufficient funds in Wisconsin to pay every dollar of that liability as set out in the contract, one hundred cents on the dollar, is that correct?

A. I think we have a legal question there, due to the segregation of the funds.

Q. Well, isn't there enough money to pay every single one a hundred cents on the dollar?

A. You are presuming, of course, it is all thrown into [fol. 1547] one hopper?

Q. That is right.

A. There is, I think.

Q. The figures show it, don't they?

A. Yes.

Q. In Illinois is there enough money, as shown by the figures, to pay back every contract holder who has an asset in that state the amount of liability owed to him by virtue of his contract a hundred cents on the dollar?

A. No, sir.

Q. Then the State of Wisconsin, with its stringent requirements, protected its contract holders a hundred per cent, didn't it?

A. That comparison is not necessarily correct, because we were not required in Illinois to keep a deposit up to July 7th 1931. From then on, from July 7th 1931, there was ample money to pay all liabilities in Illinois.

Q. Don't you believe, in your opinion as a financial expert, that every single state in which you, as a new company, would attempt to do business as a face amount security company, is now going to see that that company puts up enough so that its people get back a hundred cents [fol. 1548] on the dollar, the same as Wisconsin?

A. Take Illinois again. As soon as it passed the Legislature, we were forced to have a market value there equal to our reserve liabilities in that state, and that has been going on since 1931. If it wasn't, we were called on for another deposit and it was sent out.

Q. You don't have enough in Illinois?

A. After we were required to have it, yes. We do from July 7th 1931.

Q. Before that you didn't have?

A. We were not required to have.

Q. All right. Now, isn't it your opinion that every state, before a new company will be permitted to do business on face amount securities, that state is going to require that they are going to be protected a hundred cents on the dollar for contract holders in that state from now on?

A. That is perfectly all right, if you don't have to protect them with Government bonds.

Q. Aren't they going to find out why Wisconsin is fully protected and Illinois is not fully protected at present and adopt the Wisconsin idea, so they will get fully protected?

[fol. 1549] A. Maybe they will.

Q. And they if they do your new company can't do business?

A. If you have additional capital you can make up that ten per cent.

Q. Can you still make money?

A. That doesn't mean, as I understand, that they have the same regulations as Wisconsin.

Q. If it is the only one that gets its money back in full you can bet they will, can't you?

A. I don't think so.

The Court: You seem to lose sight of the fact that Mr. Young's distinction is that Wisconsin required securities that gave an extremely low yield, and thereby protected the contract holders in Wisconsin at the expense of the contract holders all over the United States. He says that the requirement in Illinois permitted investment in securities that yielded almost twice as much as the ones in Wisconsin.

The Witness: One and a half points more.

The Court: I thought he said in some cases he got as much as two per cent higher than he did in Wisconsin.

[fol. 1550] The Witness: That is correct.

The Court: And that is a matter you ought to take into consideration, in your question.

Mr. Palmer: I think, Your Honor, the point I am trying to bring out, that Wisconsin required such a high grade security that there wouldn't be the fluctuation that there would be in securities in Illinois, which paid a higher rate of interest, which he classified as semi-speculative.

The Witness: So long as the market value is maintained it doesn't make any difference whether it is a government, a good corporate bond or a municipal.

Mr. Palmer:

Q. But you have a lag, I believe you said, of at least thirty days?

A. That is right.

Q. And in that time the market can break so badly you won't be able to buy the good securities.

A. Not hardly. You can anticipate as bad a break as that, I think.

Q. No one has ever anticipated these bad breaks before, have they?

A. Yes, they have.

[fol. 1551] Q. Did you anticipate them?

A. Yes, sir.

Q. Why didn't you advise Fidelity in 1937 to take it in cash?

A. I did.

Q. In writing?

A. I have a memorandum that we get out of speculative bonds, and just about the time we started the bottom just dropped out, and it would have been very foolish to continue that program.

Q. Then in the lapse or the lag, with as much money as you have, you can't get out necessarily and get in good securities to take the place of speculative ones?

A. All right. I will say all through that lag Illinois was protected a hundred per cent. It is in the regulations of 1931.

Q. Are they protected as to the liabilities?

A. From the beginning of business? No, we were not required to do it until recently, and then we couldn't do it.

Q. You say that Fidelity had speculative securities in 1937?

[fol. 1552] A. I would say semi-speculative, as I said a while ago.

Q. Didn't you just tell them that you advised them to sell their speculative securities?

A. If you want to be that technical, yes; yes, sir.

Q. I want to be as technical as the words you used.

A. I would say semi-speculative instead of speculative. Everybody has got a list of the bonds anyway, and know what we have.

Q. So that we can get a definition, tell us what a speculative, semi-speculative and conservative security is.

A. I can't make the definition.

Q. Who can?

A. I don't know.

Q. How do you know one from the other?

A. Because it is just a feeling by your knowledge and your contact with the business you have to get an idea whether a bond is speculative or not. If it is a corporate bond you have got to go into the management of the corporation, you have got to see if their business is volatile [fol. 1553] enough—there are so many things that make a bond speculative or not speculative. It is not the things that Moody and Standard give them, in my opinion. Statistical companies attempt to show speculative bonds and non speculative bonds, and so forth. They go by the market price of the bonds.

Q. Who does that?

A. Moody's and Standard's. I have seen many instances like this, where a bond is put a speculative group selling at sixty, they say, "Don't buy, or sell;" if it gets up to seventy-five, the same security, they advise you to buy. So I don't think there is any real definition for it.

Q. If a bond with a par value of a hundred dollars is selling at a hundred dollars, is that considered by you to be speculative, semi-speculative or conservative?

A. Not necessary. I would have to know what the bond was.

Q. If a bond was selling at ten, with a par value of a hundred dollars, you wouldn't know whether to call that conservative, semi-speculative or speculative until you investigated it?

[fol. 1554] A. I think I would call that practically worthless.

Q. Let's get up to a bond selling at fifty, with a par value of a hundred, what is that? Is that worthless, half worthless, or what?

A. I say you have to take each individual bond. As a class, I would say it is a speculative bond, of course.

Q. Were speculative bonds what you were attempting to advise Fidelity to buy, or higher type, conservative investments?

A. We had both.

Q. Which were you advising them to buy?

A. Over the period of years?

Q. Yes.

A. I was buying largely under the rules we were operating under.

Q. Which were you attempting to buy, a speculative, semi-speculative or conservative—you yourself?

A. Both.

Q. Were you advising Fidelity to buy speculative bonds?

A. Yes, I did in certain instances—sure I did.

[fols. 1555-1572] Q. In other words, speculation means you hope the bond will be good and you can make money on it?

A. Yes.

Q. And yet you want other people to allow you to gamble in that fashion with their money by forming a new company?

A. No, that is entirely different. The speculative bonds we bought were in the accounts that were under water. We did it with the hope of making some of that money back. In a new company you have a different problem.

Q. If I understand that, you did it in accounts that were already in the hole, in the hope of gambling to get them back up.

A. I didn't want them to gamble, sir. A speculative bond does not necessarily mean you are gambling; it means you have hopes of it going up, but it don't mean that you have to sell it if it goes down and take a loss.

Q. But there is a bigger chance of it going down than a semi-speculative bond?

A. It depends on the market entirely.

* * * * * * *

[fols. 1573-1579] Mr. Huwe:

Q. Mr. Young, with reference to your testimony this morning concerning the practice of withdrawing, or, shall I say, balancing particular funds, deposits and liabilities, in each state, I would like to ask you if, when your company followed the practice of not withdrawing any securities belonging to a particular fund from a state deposit, even though that particular fund's liability was reduced, when such withdrawal would reduce the total state deposit below the total state liability, isn't it a fact your company was prevented from carrying out its obligations with respect to the balancing of each fund's deposit and liability in each state by the state laws?

A. Yes.

* * * * * * *

[fol. 1580] Q. Investors' Syndicate is one of your main competitors, is it not?

A. Yes, they are the largest comparable company in the field.

Q. It has recently incorporated a new company or new organization under the investment companies act of 1940, [fols. 1581-1591] has it not?

A. So I understand, yes.

Q. As such new company, has it qualified and is it doing business in the State of West Virginia? Do you know?

A. I don't know.

Q. You wouldn't be able to state whether it is doing business now in West Virginia under the new corporation or whether it is doing business in Wisconsin, Illinois, Tennessee, and other states?

A. I have no idea.

* * * * * * *

[fol. 1592] Q. Mr. Young, with respect to securities generally, in a time of inflation or an ascending market, what is the effect of such a situation as between extremely high grade bonds and second grade or lower grade bonds and equity securities?

A. In times of inflation?

Q. Inflation.

A. Well, the economic history shows that in time of inflation the high grade bonds go down and the second grade bonds follow equities and come up; but we are not in ordi-

nary times, so no one, I don't think, can forecast now just what will happen.

Q. But the experience of the past would teach that?

A. The experience of the past would teach that. That is the case during inflationary periods, which we have had very few, I think, in my recollection.

Q. With respect to the securities you have on deposit, [fol. 1593-1610] those are what you would term the highest grade of bonds, are they not?

A. You mean in Wisconsin?

Q. Yes.

A. Yes.

Q. So that assuming that we might have a period of increasing prices, the possibilities are that the securities you have got in Wisconsin would probably go down rather than go up. Am I correct in that?

A. It is possible, but I hardly think it is probable to any extent, due to unusual circumstances.

Q. You don't think the securities in Wisconsin will go up to any appreciable extent, do you?

A. No, I do not.

* * * * * * *

[fol. 1611] J. H. SCHELLHASE, recalled as a witness on behalf of the debtor, testified as follows:

* * * * * * *

[fol. 1612] Mr. Fleming:

Q. I will ask you to refer to debtor's Exhibit 69 and state whether or not that was prepared by you.

A. Yes, it was prepared by me.

Q. Would you explain that to the Court, if you will, please.

Mr. Lauritzen: Is this the paper that is in evidence already?

Mr. Fleming: No, this is a compilation giving a breakdown of the income of Fidelity, the various sources of income, for the year October 31st, 1939 to October 31st, 1940.

Mr. Lauritzen: Is it by funds or overall?

The Witness: It is by funds—the gross income by [fols. 1613-1635] funds taken from the audit report of Haskins and Sells.

Mr. Fleming:

Q. You may proceed, Mr. Schellhase, and explain the exhibits.

A. Of course, this schedule shows the interest on investments, the dividends on stock, rent from real estate, profit from disposal of investment securities, interest on interfund loans, interest on loans to contract holders, interest on past due collections, gain from surrender of contracts, underwriting fees and commissions earned, and participation in surplus earnings of contract funds, miscellaneous income. A gross income of $1,630,173.09.

As of today, of course, some of this income we are not receiving, like the loading from contract payments and so on, which we were in 1940; so I have eliminated some of those items, and it gives you a net total of gross income, after eliminations, of $1,061,460.37.

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[fol. 1636-1639] By Mr. Farmer:

Q. Your compilation here, Mr. Schellhase, is taken from a figure set out in Haskins and Sells' audit report filed as Exhibit 14 in this case?

A. That is correct.

Q. That audit report contains a statement of income for the year ended October 31, 1940 for each of these special funds and for the general fund, does it not?

A. That is correct.

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[fols. 1640-1647] Q. The next is the general fund and agency division. Does that show a net loss of $196,021.10?

A. That is correct.

Q. And no provision was made during the year for federal income taxes?

A. That is correct.

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[fol. 1648] Q. Mr. Schellhase, what are the most recent series of face amount contracts or certificates that have been issued and sold by Fidelity?

A. The Series B and the Series D contracts.

Q. Which of these accounted for the largest volume of business?

A. The Series B.

Q. When was the Series B contract issued and sold?

A. It was issued and sold from June 15 to December 31, 1940.

Q. In how many states was this series of contracts sold?

A. In approximately sixteen.

Q. What were the five or six principal states in which the volume of these sales were made?

A. Illinois, Michigan, Pennsylvania, West Virginia and Wisconsin.

[fol. 1649] Q. Missouri?

A. Missouri.

Q. Some of those states required deposits and others did not?

A. That is correct.

Q. Which of those that you mentioned required deposits?

A. Of course, Illinois required deposits; Michigan did not. Pennsylvania required a minimum deposit of a hundred thousand dollars.

Q. But not applicable to Series B?

A. Not applicable to Series B. West Virginia and Wisconsin required deposits.

Q. Missouri?

A. Missouri required deposits.

Q. Approximately what percentage of the total Fidelity assets today are Series B assets?

A. I would say approximately thirty-five per cent.

Q. Was the Series B contract available in more than one form or more than one additional privilege to the holder?

A. No, sir, there was but one Series B contract, but it [fol. 1650] could be issued with or without insurance, according to the option of the contract holder himself, and of course it so stated on the front of the contract, that it would be issued under Section Six, which is with insurance, or Section Seven which is without insurance.

Q. Was the Series B contract the only Fidelity contract that did have the insurance feature available?

A. Yes.

Q. Approximately what percentage of the contracts that were originally issued carried the insurance feature of Series B?

A. Approximately seventy-five per cent, took the insurance feature. Of course, on the books of the association it would probably average at that time about sixty-seven per cent, the total number that carried the insurance and the amount that let it lapse. There was about sixty-seven per cent with insurance and thirty-three per cent without insurance

Q. As of what date?

A. Well, that is of April 10th.

Q. What year?

[fol. 1651] A. 1941.

Q. Can you explain for the information of the Court just what this insurance feature is that is presently outstanding with respect to Series B?

A. Of course, it is—it is a group life insurance, and in case a contract holder should die that any given payment we would receive from the insurance company enough money to pay the contract in full, or to complete the payments on the contract.

The Court: Would you get that all at once, or would the insurance company simply pay the payments as they came due?

A. No, you would get it all at once, in which case your contract would be paid in full.

Q. Would you get the commuted value or get the actual total cash that would be paid over a series of years?

A. No, you would get the commuted value or the net value that was necessary to pay that.

Mr. Palmer: Could we have an example of that in figures, so we could understand what that commuted or net value was?

[fol. 1652] A. It is the present value of the contract. In other words, enough money so that at the maturity of the contract there would be enough there, improved at the same rate of interest, to pay the maturity value of the contract.

Mr. Jaegerman:

Q. Would the beneficiary be entitled to receive that amount immediately, or what was the practice of the company with respect to that?

A. Well, there is a cash surrender value placed upon the contract—an increased cash surrender value. Of course, that is according to actuarial tables and figures, the amount of the cash surrender. The payment practically covers the amount of that cash surrender. It has an increased cash surrender value every month.

Q. Then the beneficiary could hold the contract and turn it in to Fidelity at the maturity date and get the matured amount?

A. That is correct.

Q. And turn it in at any time prior to that date and receive a commuted cash value?

A. That is correct.

Q. What was the unit face amount of this Series B?

[fol. 1653] A. $1,250.00.

Q. What were the payments to be made?

A. $7.50 a month for a period of one hundred and twenty months.

Q. What does that total?

A. $945.00.

Q. Out of that $945.00 was Fidelity Investment Association entitled to make any deductions?

A. Yes, they were.

Q. For what purpose?

A. For loading and sales expenses and advertising.

Q. What was the permissible loading deduction on a unit contract?

A. The permissible loading deduction——

Q. To the agency.

A. To the agency division was $46.60, which was paid over a period of the first eight months.

Q. So out of the first eight payments of $7.50 the association would deduct or take $46.60 as its agency fee?

A. That is correct.

Q. What would be done with that money?

[fol. 1654] A. Part of it would be paid as commission to the salesman and the balance would go to the agency division administrative expenses.

Q. Accountingwise, would that $46.60 go into what you describe as the general fund or stockholders' fund profit and loss account?

A. I would say it would, yes.

Q. What was the next fee, and when was it deducted?

A. The association received an underwriting out of every payment except from the one hundred and eighth to the one hundred and twentieth month, a total of $36.13. It also received advertising fees payable out of the ninth payment of $1.97, making a total on a without-insurance contract of $84.70. On a with-insurance contract we deducted fifty cents a month for the first sixty months and twenty-five cents a month for the next sixty months, making a total of forty-five dollars. On a with-insurance contract that was used as insurance premiums for insurance—to carry the insurance. On a without-insurance contract it went into a special reserve fund as an additional credit reserve returnable to the contract holder.

[fol. 1655] The Court: Did the company get any of that?

A. It did, Your Honor, on insurance protected contracts it received the $45.00 if all the payments were made, making the total for loading on an insurance protected contract of $129.70.

Q. Did it get any of it on contracts where the owner died before maturity?

A. Well, it only got up until the time of death.

Q. I mean by asking you whether the company got it or not, I assume that this insurance was secured through some insurance company?

A. That is correct.

Q. Did you pass on that fifty cents or twenty-five cents to the insurance company, or did you keep part of it?

A. What we would do is figure the amount of insurance premiums that are due to the insurance company. Then the insurance premiums of fifty cents a month on all contracts are put into one account on the ledger, and from them the insurance premiums are paid for all of the contracts out of that one account in the ledger.

Q. You still don't get to my point. The insurance premi-
[fol. 1656] ums are paid to the insurance company, did they equal or exceed or were they less than the amount paid by the contract holders?

A. They were a little less, because there was some arrangement whereby the insurance company would reduce——

Mr. Jaegerman: A little louder.

A. There was some arrangement whereby the insurance company would either reduce the premiums or give us a refund of some of the premium back if our mortality rate was low. It all depended on whether our mortality rate would be low so we could get back a refund of some of those premiums, otherwise we would be paying out more than we received.

The Court:

Q. Do you know about how much profit went to the company out of those insurance premiums paid?

A. No, sir, I don't, Your Honor, offhand.

The Court: All right; go ahead.

Mr. Jaegerman:

Q. You do know, do you not, that those amounts were substantial in the last several years?

[fol. 1657] A. I wouldn't say they were too substantial, but they were—I don't like to venture a guess——

Q. They were an income item to the company?

A. Yes, they were.

Q. Was this contract sold with a cash surrender value feature?

A. Yes, it was.

Q. When did that become operative?

A. At the end of the twelfth payment.

Q. At the end of the twelfth payment how much would the holder have paid to Fidelity?

A. Ninety dollars.

Q. How much would the holder be entitled to as cash surrender value?

A. $25.00 on a with-insurance contract—on a without-insurance contract he would be entitled to $31.13.

Q. On a Series B contract without insurance, to what point would the holder have to carry that contract by monthly payments before the holder could withdraw from Fidelity as a cash surrender as much as he had paid Fidelity?

A. Did you say on a without or with?

[fol. 1658] Q. On a Series B contract without insurance.

A. Without insurance, he would carry it to the eighty-

ninth month. At the eighty-ninth month he would have paid in $667.50 and he would receive $667.00.

Q. What are the appropriate months for Series B contracts with the insurance feature?

A. With the insurance feature it would be the one hundred and ninth month. At that time he would have paid $817.50 and he would have received $817.50 as a cash surrender.

Q. Mr. Schellhase, you testified that this series was first offered on June 15, 1934.

A. That is correct.

Q. What year was the greatest volume of Series B contracts sold?

A. 1938.

Q. What is your estimate as to the average age of the Series B contracts presently in existence?

A. I would say between forty and fifty months.

Q. Would that mean that if the average Series B contract holder were even to get his full cash surrender value he would get back less than he had paid in to Fidelity?

[fols. 1659-1670] A. Oh, yes, he would get back less.

Q. Substantially less?

A. Yes, I would say.

* * * * * * *

[fol. 1671] Austin L. King, called as a witness by the state court receivers, having been duly sworn, testified as follows:

Direct examination.

By Mr. Palmer:

Q. State your name, please.

A. A. L. King.

Q. Where do you live?

A. Wheeling, West Virginia.

Q. Were you formerly connected with Fidelity Assurance Association?

A. Yes, sir.

Q. How many years were you connected with them?

A. Directly and indirectly approximately twenty-five and a half.

Q. What various positions did you hold with the company?

A. Director, Assistant Treasurer, Vice President, Comp-
[fol. 1672] troller and Secretary.

Q. During what period of time did you serve as a director of the company?

A. I can't answer that definitely. I think approximately twelve to fifteen years, but not consecutively.

Q. Not consecutively. Were you a director during most of the time from 1922 to 1941?

The Witness: State the question.

(The question was read.)

A. Yes, sir.

Mr. Palmer:

Q. Mr. King, as such director, were you familiar with the legal services rendered to the company by the various attorneys who rendered legal services to the company and were paid therefor?

A. Yes, sir.

Q. Were you familiar as a director, with the amounts paid to those attorneys—not asking you to recall any given amount or definite amount?

A. Generally, yes.

Q. Will you tell the Court whether or not the board of directors, as such, approved of all of the fees paid to the various attorneys whom the company employed?

[fol. 1673] Mr. Ray: I think the minutes of the board would be the best evidence of that.

The Court: Well, let him answer if he knows. Go ahead.

A. All attorneys' fees were paid either before approval or after approval, but if paid before approval, were approved by the board.

Mr. Palmer:

Q. Were they first submitted to the general counsel of the company for investigation and report on them?

A. Many of them were, not all.

Q. The ones which were larger were submitted and the smaller ones perhaps not? Is that correct?

A. Many of them we submitted to what we know as our general attorney, the smaller items, for his approval.

Q. Mr. King, were you familiar with the work done for Fidelity by Mr. A. B. Koontz and members of his firm?

A. Yes, sir.

Q. And were you familiar with the amounts paid therefor in general?

[fol. 1674] A. Generally, yes, sir.

Q. Can you state, in your opinion, as to whether or not proper services were rendered for the amounts charged for the fees?

Mr. Ray: I object to that, Your Honor.

A. I think so.

Mr. Ray: I think that is objectionable. He is not——

The Court: Well, it is all right if he has any basis for his opinion in knowledge of the services and their value.

Mr. Palmer:

Q. Were you closely associated with Mr. A. B. Koontz in the work of Fidelity?

A. Well, for a number of years he was a director and represented the association as attorney through his firm, and naturally I was familiar with his work and——

Q. Were you familiar with the services that were rendered to the company by him and his firm—legal services?

A. Yes, sir.

Q. And it was of those and of that knowledge that you were speaking when you gave your answer? Is that correct?

[fols. 1675-1678] A. That is right.

* * * * * * *

[fol. 1679] Mr. Huwe: Your Honor, I think that that was [fol. 1680] a de facto directors' meeting, and therefore seven de facto directors, the necessary quorum, were present, Mr. Fleming being a de facto member, and those other members who did not qualify, we would say, if it is true, under the Investment Company Act, they were also de facto members, which makes their action perfectly valid.

The Court: That is a question for argument, and we are now developng the facts, and I don't think there is any contention on the part of anybody that there were more than six directors of the company at the beginning of that meeting.

Mr. Palmer: That is correct, Your Honor, and I was merely directing that to the witness's attention so we could get past the preliminaries and get into the points I wanted to examine him about.

Mr. Reinhardt: If Your Honor please, the Court's statement about that is not in accordance with my recollection, and I want to be set straight.

The Court: Maybe the Court needs to be set straight.

Mr. Reinhardt: It is my recollection that the testimony showed that there were six people present in Pittsburgh at some meeting on June 3rd, and that they purported to elect [fol. 1681] a seventh person as a director, and that then a directors' meeting was called. Is that in accordance with the fact?

Mr. Palmer: I can only ask one question at a time. I was going to develop that by Mr. King, and I thought there was no controversy about it, as the Court has said. I thought there would be no controversy about my preliminary question to refresh the witness as to what I was talking about.

The Court: That is my understanding.

Mr. Reinhardt: And as I recall, it was after Fleming's purported election as a director that what was called a directors' meeting was called.

The Court: I am not so sure of that, but anyway I am going to let Mr. Palmer go ahead with his question, even though it is technically objectionable.

Mr. Palmer: Read the question.

(The question was read.)

A. There were not seven present when the meeting was called to order as a directors' meeting.

Q. Mr. King, is it a fact that the six directors who were present at this meeting when it was called to order were [fol. 1682] John Marshall, Sr., John Marshall, Jr., A. L. King, F. H. Pulfer, H. E. Reed and A. G. Messick?

A. That is correct.

Q. Was there also present Mr. James R. Fleming, of Fort Wayne, Indiana?

A. Yes, sir.

Q. At that time, when the meeting was called to order, it is true, is it not, that he was not a director of the company?

A. That is right.

Q. That is the same Mr. Fleming who has been present here as counsel for the debtor? Is that correct?

A. Yes, sir.

Q. Mr. King, is this correct, that James R. Fleming suggested to the secretary of the corporation, F. J. McNulty, who was present at the meeting, that he become and be elected a member of that board of directors, that Mr. McNulty declined so to serve?

A. That is correct.

Q. And is this further true, that thereupon the said James R. Fleming stated, in effect, that he deemed it preferable for him, James R. Fleming, in the light of future matters, [fols. 1683-1684] not to become a member of said board, or serve thereon, but that as an emergency confronted them, and to make a quorum, he would consent to become a member of the board of directors at the meeting thereof held at Pittsburgh on June 3, 1941, and would resign at the close of that meeting?

A. In substance, that is correct.

Q. And that thereupon the said James R. Fleming was elected by the six directors in attendance at said meeting to be a member of the board of directors?

A. That is right.

. . . . . .

[fol. 1685] Q. Mr. King, will you give the Court your reason why you did not vote at the meeting in Pittsburgh to have the debtor file a petition in the United States District Court? Will you speak as loudly as you can, too, Mr. King, so we can all hear it?

A. Well, in discussing the matter briefly, which was very briefly, before this resolution was presented, I took the position that the receivers had not had time to submit a plan as had been anticipated or expected. In other words, when [fol. 1686] we did not fight the receivership case, it was understood very definitely that we would make answer to the court with a plan in due time, as quickly as possible. That had not been done. While I knew nothing definitely about what was being done by the receivers as to the plan or general work they were doing, I did know something about it through my contact with former employees and junior officers that were still in the organization—I knew they were working diligently on some plan; and I felt that they should have an opportunity, at least, to present this

before further steps were taken, that it was only consistent, and I felt that way very strongly, about it. I did feel that eventually, as it was generally understood, the matter would perhaps have to, after certain work was done through this state, be presented to the Federal Court in order to do some things that couldn't be done in the Circuit Court, and that was my reason for not voting for the resolution.

The Court:

Q. In other words, as I understand, Mr. King, you felt that it was premature?

A. I did, yes, sir.

The Court: All right.

[fol. 1687] Mr. Palmer: You may inquire.

Cross-examination.

By Mr. Ray:

Q. I understand you to testify that Koontz and Koontz were employed as attorneys for the Fidelity Investment Association in the proceedings in the state court in which receivers were appointed?

A. That is correct.

Q. When was that action taken?

A. I do not recall the date.

Q. You were at the board meeting at which that action was authorized?

A. Yes, sir.

Q. And did the firm of Koontz and Koontz accept that employment?

A. That is my recollection.

Q. And then you were at that time a vice-president——

A. I was.

Q. (Continuing:) of the association?

A. I was.

Q. Then it was your understanding as a vice-president of this association that at the time this proceeding was [fol. 1688] instituted in the Kanawha Circuit Court in which Isaiah Smith and Ross Thomas were appointed receivers in that court, the firm of Koontz and Koontz was representing the Fidelity Assurance Association in that proceeding?

A. That is correct.

Q. I believe you stated that it was your opinion at the meeting in Pittsburgh that this proceeding—that this reorganization—would eventually have to be completed in the Federal Court?

A. Just what do you mean by reorganization?

Q. Well, what did you mean by it?

A. I don't believe I mentioned the name reorganization.

Q. What was the term that you used that would have to be completed in the Federal Court?

A. I don't recall the term that I used, but I don't believe I mentioned reorganization.

Q. You did say something would have to be completed in the Federal Court, in your opinion, didn't you?

A. Yes, sir.

Q. And did you not mean the reorganization of this association?

[fol. 1689] A. No, not especially. I felt that the various state departments that held these securities would not release them unless it did go though the Federal Court.

Q. Was it your opinion that it would be advisable that it should go through a Federal court?

A. Not at that time. After we had definitely—very definitely—considered the matter and felt that the other plan would not work out. I thought that it was entitled to a chance, or at least a plan prepared and presented to the court.

Q. Would it be possible in the state courts to have any plan of reorganization made effective which was not entirely voluntary?

A. I didn't get that question.

(The question was read.)

A. I don't know.

Mr. Gray: I object to that question. That is a question for the Court, and not for this witness.

The Court: The objection is sustained on the ground that that calls for a legal conclusion of the witness.

Mr. Ray:

Q. What was the plan which you were awaiting, Mr. [fol. 1690] King?

A. I had no plan. The receivers were to prepare a plan, as I understood it, very definitely to present to the court.

Q. Were the receivers ordered by the state court to prepare a plan?

A. I wouldn't say. My recollection is that that was in the order.

Q. Did you ever have any conversation with the receivers in which they stated that they were preparing a plan?

A. I also talked to the receivers at one time and their attitude was that they were going to get to work and prepare a plan just as rapidly as possible.

Q. But you were never advised of any plan prepared by them——

A. No, sir.

Q. (Continuing:) Or any plan which they had under way?

A. No, sir.

Q. I want to ask you if at the directors' meeting in Pittsburgh, when the vote was taken on this resolution to file [fol. 1691] the petition, under Chapter Ten, the members present were not polled individually and every member present voted in favor of the adoption of the resolution and the chairman announced that the resolution had been unanimously adopted.

A. There was no such announcement made at the meeting. Had there been I would have immediately verbally told them that I was refraining from voting, but as there was no such announcement made I did not think it was necessary.

Q. Will you state just exactly what Mr. Fleming said at this meeting after Mr. McNulty refused to be elected a director?

A. The passage that Mr. Palmer read is as near what he said as I can state it.

Q. Can you state it now, what Mr. Fleming said, from what you know yourself?

A. Well, he stated in effect that he would prefer not to serve as a director, but it seemed that we were there in session and that an emergency existed, and he interpreted the by-laws to mean that he could be elected as a director, and I agreed myself that he could be, and he announced [fol. 1692] at the time that he would immediately resign at the close of the meeting. Naturally, being elected a director and serving, he had a perfect right to resign at any time he saw fit. That was my reasoning on it.

Q. I think you are right; Mr. King, in respect to that, and you voted for it?

Mr. Palmer: I ask that the remark of counsel be stricken from the record.

The Court: Overruled.

Mr. Ray:

Q. You voted for Mr. Fleming as a director?

A. I did.

Q. And you thought it was a proper election under the by-laws of the association?

A. Yes, sir.

Q. Is it not a fact, Mr. King, that previously in the history of this company there have been vacancies on the board and six members of the board have met, have elected a member to the vacant position on the board of directors, and then held a directors' meeting?

A. Yes.

[fol. 1693] Mr. Palmer: Just a second, Mr. King. I object to that, Your Honor; it has nothing to do with the question of the legality of that meeting.

The Court: Overruled.

Mr. Palmer: Exception.

A. That is correct.

Mr. Ray:

Q. And I will ask you if there was not such a meeting held on December 23rd, 1940, at which the general attorney for the company, Mr. Foulk, was present, and at which Mr. Gribben was elected a director to make the seventh director?

A. Yes, sir.

Mr. Palmer: I object to all of this, Your Honor.

The Court: Overruled.

Mr. Ray:

Q. I believe you wrote the minutes of the meeting of June 3rd?

A. I did.

Q. The directors' meeting of June 3rd?

A. I did.

Q. And what took place there is fully set out in the minutes, so far as you have any knowledge thereof?

A. That is correct.

[fol. 1694] Q. What services did the firm of Koontz and Koontz render Fidelity Association during the period from December 31, 1940 until April 10, 1941?

Mr. Palmer: Just a second, please. Your Honor, I asked Mr. King certain questions in order to clear up any impressions that might be wrongly existing in the record. I have already made a motion—I don't know whether Mr. Ray received a copy of it, because he wasn't of counsel at the time the motion was mailed out—to strike the question of attorneys' fees from this record. However, as I stated to the Court before, if we go into them I am not going to pick on the firm of which I am a member and single that out; we are going into every attorney's fee—that the Court thinks proper, of course—and every other auditing and every other unusual expense. I don't think it has any bearing in this case other than to attempt to embarrass certain counsel.

The Court: It may have been somewhat immaterial at the time it was first brought up, but during the hearing from September 15th on you have examined the witnesses with reference to the suitability of the receiver, Mr. Ross [fol. 1695] Thomas, who is shown to be a member of the firm of Koontz and Koontz, or at least associated with them. Now, on the question of this suitability as a receiver and as to whether the pending receivership is a receivership that would result in the best interests of all parties concerned, the Court feels that the prior connection of the firm of Koontz and Koontz—not every attorney, but the firm of Koontz and Koontz—with Fidelity becomes a very material thing, and as to the services performed and as to the compensation received and as to any and all connections that that firm had with this company, particularly if such connection had anything to do with the present condition of the company—I don't say that there is any indication yet that it had—but I do say that those things ought to be fully developed for the information of the Court; so I will overrule your objection.

Mr. Palmer: May I have my exception, please?

Mr. Ray: Read him the question.

(The question was read.)

Mr. Ray: I would like to amend that, April 5th, 1941.

[fol. 1696] A. Well, I know generally that they were representing the Fidelity in connection with the qualification

—qualifying as an insurance company and with the state departments—State Auditor—but I do not know the details. I am not familiar with the details. That was handled entirely by the president and others in the official family there. I had no particular first hand knowledge as to just the details of what was being done, but I knew generally they were handling that.

Mr. Ray:

Q. Then, I take it, you don't know what lawyers of the firm worked on any business for the association, do you?

A. Well, previously Mr. Goldsmith——

Q. I am talking about this particular period.

A. I do not.

Q. You don't know what particular matters they worked on?

A. No, sir.

Q. You don't know how many hours they worked on those matters?

A. No, sir.

Q. You don't know what their success or failure was with [fols. 1697-1709] respect to any matters, do you?

A. No, sir.

Q. Do you know how much was paid to that firm during this period?

A. No, sir.

* * * * * * *

[fol. 1710] Mr. Huwe: So that the information you had upon which you based your feeling and opinion that the state court receivers of West Virginia should have more opportunity to formulate a plan, did not include informa-[fol. 1711] tion that over a million dollars' worth of securities were sold in Wisconsin at that time, did it?

A. I didn't have that information.

Q. Would you qualify your opinion about the feasibility of a plan formed by a state court receiver under those circumstances? Would that change your mind, if you knew that a million dollars' worth of securities in Wisconsin were sold at that time?

A. I will have to think about that.

Q. How much time do you want?

A. I was not closely associated with the home office up there after the receivers were appointed. In other words,

I was out of the business. The information I received from time to time through contacting and talking with Mr. Foulk, who was connected with the receivers, and the association, was that the state departments, these ancillary receivers they are called, I believe, were co-operating.

Q. That was your information?

A. That was the information I got, and I based my opinion at that time on the information I had.

Q. Are you aware that Illinois likewise was preparing [fol. 1712] to liquidate the assets in Illinois?

A. No, sir.

Q. You didn't know that either?

A. No, sir.

Q. Now, there are three and a half million assets in Illinois, and I believe there are over two million in Wisconsin, a total of over five million. Now, if you had known on June 3rd that over five million dollars of your twenty-five million of assets, one-fifth, twenty per cent, was being or was about to be liquidated, would you have changed your opinion about giving the state court receivers more time to formulate a plan?

A. Possibly I would.

Q. Are you of the opinion that this company ought to be reorganized in a state or a federal court proceeding?

A. What do you mean by reorganization?

Q. Well, obtaining new capital, probably modifying in some degree the rights of contract holders, as would be done in a state court receivership or a federal court receivership.

A. I am in favor of anything that will protect the con- [fol. 1713] tract holders. I don't believe, regardless of the capital that is put into the association in the reorganization plan, and whether by the contract owners or outside people, it could be successful again in operating as Fidelity Assurance Association.

Mr. Palmer: Objection. That is not the way to present a plan for reorganization.

A. I further believe, if I may state, that if any plan could be developed whereby the company as a whole could be taken over by some other organization and reorganized in that manner, that that would be the better thing to do.

Mr. Huwe: Q. So that you do have an opinion that the company should be reorganized for the benefit of the contract holders?

A. If the reorganizaton plan is a better plan than liquidation.

Q. Do you think it would be better for the contract holders to have the company reorganized than liquidated?

A. It would depend on the type of reorganization.

Q. In other words, your answer would be contingent upon the plan that is formulated?

[fol. 1714] (Witness nods.)

Mr. Huwe: That is all.

Redirect examination.

By Mr. Palmer:

Q. Mr. King, is it not a fact that in Detroit in December of 1938, the Securities and Exchange Commission filed a suit against Fidelity and all of its officers to enjoin them from further proceeding with the business of selling, in substance? The suit was only against the company, not against the officers.

A. That is correct.

Q. Was it necessary that you employ attorneys to defend that proceeding?

A. That is correct.

Q. To your knowledge was there considerable legal work done in that proceeding by your company attorneys including Koontz and Koontz?

A. My general knowledge was that there was a great deal of legal work.

Q. Shortly thereafter was there a receivership suit brought in the northern district of West Virginia in United States court?

[fol. 1715] A. That is correct.

Q. Was there a lengthy hearing before the judge of that court and before a master appointed by that judge?

A. That is correct.

Q. Were not only Koontz and Koontz engaged in that, but your general counsel, Mr. Tom Foulk, and special counsel, Mr. Austin Wood, engaged in behalf of the company?

A. That is correct.

Q. And after that lengthy proceeding in 1939, was that not followed by an appeal to the Circuit Court of Appeals?

A. That is correct.

Q. And as to the success of those things, didn't your company remain out of receivership at that time?

A. That is correct.

Q. And your attorneys accomplished that to your knowledge?

A. That is correct.

Q. They won in both the lower court and the Circuit Court of Appeals on the receivership suit?

[fol. 1716] A. That is correct.

Q. And did you know that there was an enormous amount of work done by the attorneys in those two suits?

A. That is correct.

Q. Isn't it a fact that from the firm of Koontz and Koontz Mr. Arthur Koontz and Mr. Walter Goldsmith and Mr. Harry Lambert were all three in Wheeling?

A. The last?

Q. Harry Lambert.

A. I never met him, but I believe there was a gentleman there by that name.

Q. These three members of that firm were in Wheeling working on it?

A. That is correct.

Q. Do you know how many weeks or months they were in Wheeling during that one suit, approximately?

A. I think approximately three to four weeks.

Q. Do you know how long the proceedings went on in Federal Court in Detroit?

A. I do not.

Q. Were they some length of time?

A. Possibly a day or two.

[fol. 1717] Q. And were you able to go on with your company after those proceedings were finished?

A. Yes, sir.

Q. Did you also know that there was a report being prepared so that you could comply with certain laws passed by Congress for making certain reports to the Securities and Exchange Commission in 1939 and 1940?

A. Registration reports?

Q. Yes.

A. Yes.

Q. Did you know that there was an enormous amount of work in that to be done?

A. Yes, sir.

Q. And did you know that Koontz and Koontz, in connection with your general counsel, Mr. Tom Foulk, were doing that?

A. Yes, sir.

Q. And did you know that Mr. Ross Thomas was playing a large part in preparing that registration report?

A. Yes.

Q. State whether or not there was a great deal of work in that.

[fol. 1718] A. Well, the report would speak for itself. It was about two inches thick, including statements and kindred matter.

Q. And all of that had to be prepared from the company records, and translated into the proper form? Is that correct?

A. That is my understanding.

Q. Who worked actively, of your official group of Fidelity, with Koontz and Koontz in these matters—what officers of the company?

A. Mr. Fred Risley, I think Mr. McNulty to some extent, Colonel Thompson was president at that time, and a member of the committee, and various junior officers and clerks.

Q. I believe you stated that Koontz and Koontz were receiving a retaining fee of $200 a month?

A. That is correct.

Q. And then they were paid for other items of work which they did? Is that correct?

A. That is correct.

Mr. Palmer: Now, if Your Honor please, I ask that the attorney for the debtor state in open court into the record [fol. 1719] whether or not they intend to produce any evidence either that the work was not done or that the fees charged therefor were unreasonable by Koontz and Koontz, and if they do not care to state that into the record, that this evidence be stricken out.

Mr. Ray: May it please Your Honor, I didn't put this witness on the stand to show that Koontz and Koontz had done legal services for which they had been paid a fair and reasonable compensation. He was so produced by Mr. Palmer. He put him on the stand and he had him testify that the firm had done these services and that the fees were

reasonable, and all I did was to attempt, perhaps ineffectually, to show on cross-examination that the witness did not know what he was talking about, and that he wasn't competent to express an opinion such as he had done.

Mr. Palmer: Will the debtor either state one way or the other that the fees were unreasonable or services were not performed or that they are not interested in that feature, so we will know how far we shall go?

Mr. Ray: I am sure that I am not called upon to express any opinion about the firm's legal services, because I don't [fol. 1720] know what it did.

Mr. Palmer: Is the debtor prepared to produce any evidence on it one way or the other?

Mr. Ray: I see no reason why we should at this state of the proceedings.

Mr. Palmer: I don't either, so I move to strike all testimony out until the report under 167 comes in.

The Court: The testimony will not be stricken out, but will be retained in the record, but only for the purpose of its bearing upon the suitability of Mr. Ross Thomas as one of the state court receivers under the inquiry in Subsection 4 of Section 146, Chapter 10, as to whether or not there is a pending proceeding in which the rights of the parties will be better subserved.

Now, is there anything else that can be done this afternoon? We had better get through with Mr. King.

Mr. Palmer: I have finished with Mr. King. If any others have questions of him, I think he should be questioned now and be free to leave.

[fol. 1721] Cross-examination.

By Mr. Reinhardt:

Q. Mr. King, you are familiar generally with the problems that confronted Fidelity at the end of 1940 and the beginning of 1941, and the consideration that was given to those problems; are you not?

A. Yes.

Q. Will you outline for us very briefly the consideration that was given to the problem of reorganizing Fidelity, if consideration was given to that problem, during the beginning of 1941?

A. The beginning of 1941?

Q. Well, start at any convenient period that will give us a full picture of the consideration that occurred during 1941. If you have to go back a little, go ahead.

A. Well, with the amended S. E. C. Statute—whatever you call it—coming into force on January 1st, we knew previous to that time that we could not continue to sell our contracts as Fidelity Assurance-Investment Association after that date. We felt, in view of the fact that we had been selling an insured contract for a period of four or five years which appealed to the public, that we could con-[fol. 1722] vert our association into an insurance company and broaden our field of activity to include other types of insurance and make a specialty of the sale of an insured contract that would pass the requirements of the State Insurance Commissioner.

Q. You were going to expand your field?

A. That is right; that is right. And with that in view, we decided to change our name, change our type of business from an investment contract or investment certificate, as you people class it, to an insurance business; and that was the procedure that we were trying to work out. We did change our name. We made application for license as an insurance company, but we were never able to actually start selling and operating. We had our material, our contracts, our policies and everything, our sales material ready in great part, not complete, but had we been able to operate it would have only required a week or two to have completed our material and placed it in the hands of our agents for sale. Licenses were also issued to our salesmen that we made application to license, but we were instructed, "Don't deliver the licenses until" we had been advised or informed by the insurance commissioner that it was all right to go ahead.

[fol. 1723] Q. And you never were so advised by the Insurance Commissioner?

A. No.

Q. What held up your plan? What interfered with your plan?

A. I don't believe I could answer that question. The Insurance Commissioner made some demands that required some things to be done that seemingly couldn't be done or were not done, and I think that was the reason.

Q. And early in April there was a receivership proceeding?

A. That is right.

Q. Did you know in advance about this receivership proceeding?

A. A day or two in advance.

Q. On April 4th some action was taken by Mr. Sims?

A. I believe that is correct, approximately a week before the receivers were appointed.

Q. And you were apprised of that?

A. We were instructed, is my recollection, to discontinue paying cash surrenders or making loans on contracts and to impound the payments that came in. I think that was [fol. 1724] April 4th.

Q. And was it around that time that you hired Koontz and Koontz for the purpose of this receivership proceeding?

A. I believe so. That is my recollection.

Q. Do you know what pleadings or what papers were filed by the company in the receivership proceeding?

A. No, I don't.

Mr. Palmer: I think the records of the Circuit Court of Kanawha County would speak as to that, your Honor.

The Court: Well, he doesn't know anyhow.

Mr. Reinhardt: Do you intend to produce those records, Mr. Palmer?

Mr. Palmer: I can't answer that offhand, Mr. Reinhardt, but I can answer in the morning. If there is anything you want, of course I will be glad to produce copies of it for you.

Mr. Reinhardt: Well, offhand, I should say that at a minimum this record should contain the petition and answer. As I recall, the petition is in.

Mr. Palmer: There was no answer. No answer was filed by anyone, not even an appearance was filed.

(The colloquy contained in the foregoing fourteen lines was read at Mr. Reinhar-t's request.)

[fol. 1725] Mr. Palmer: There was an appearance filed, but no consent to nor denial of the receivership was filed, and I think the receivers' reports from time to time were filed in the proceedings.

Mr. Reinhardt: You would know whether that matter is going to help the Court. I have no familiarity with that. If it would help the Court I think it ought to be produced.

Mr. Ross B. Thomas: I am familiar with the reports, but they cover special matters, such as borrowing money to liquidate a loan at Continental Trust Company.

Mr. Reinhardt: I will await your answer in the morning.

Mr. Palmer: Suppose Mr. Thomas and I confer as to whether those reports would give any information to this Court other than the work done by the receivers. I don't think the Court is interested in whether they have done a great or small amount of work, but if there is anything in the papers which will aid the Court in this determination, we will be glad to file them.

Mr. Ray: You said an appearance was made. Was it by the Association?

Mr. Palmer: Yes, by the Association.

[fol. 1726] Mr. Ray: What attorney made the appearance?

Mr. Palmer: I presume Koontz and Koontz.

Mr. Ray: I would like to know.

Mr. Thomas: You want to know the name of the individual attorney?

Mr. Ray: Yes, sir.

Mr. Thomas: Mr. Goldsmith.

Mr. Ray: Who presented the bill to the Court?

Mr. Palmer: If you want to examine witnesses, Mr. Ray——

Mr. Ray: You started out here to make certain statements about that proceeding. I am just trying to get it complete.

Mr. Palmer: I was only trying to answer Mr. Reinhardt's question that we give him any information we could in the way of the papers that were in the Circuit Court.

The Court: Well, it seems to me that attorneys can give information that will shorten the taking of testimony. If they get technical, and require witnesses to be put on the stand, I think they ought to be put on. This Court doesn't want to be trifled with by technicalities in order to satisfy counsel's pride or whatnot. We want to get at the truth.

Mr. Palmer: That is correct, your Honor; that is what [fol. 1727] we all want.

Mr. Reinhardt: I wonder if we can't handle this whole thing by Mr. Palmer's statement in the morning.

The Court: All right; let's do that.

Mr. Reinhardt:

Q. Mr. King, what discussion was there of a program for the Company in connection with this receivership proceeding?

A. A program for what?

Q. For anything. Where did you think the receivership proceeding was going to be? What did you think would be accomplished or what did you hope would be accomplished?

A. Well, my impression was that in order to have a starting point the Court had to step in and stop the payment of surrenders, maturities and loans. Then we would have a starting point to prepare a plan to submit to the contract owners or the stockholders or both. That was the impression I got. I think it is correct.

Q. Was there any discussion of this matter among the Directors?

A. Yes.

Q. Will you tell us what the nature of those discussions was?

[fol. 1728] A. It was right along that line, that we had to have a starting point to prepare a program to submit to the contract owners, and it was just a general discussion on that subject.

Q. On April 4th there was this so-called freezing order which accompanied what you have referred to as the starting point, and that followed on April 11th by the appointment of receivers. Was there any discussion among the Directors after the appointment of receivers as to the course of the receivership?

A. As to the cost?

Q. The course—the future of the company.

A. Well, the discussion was that we could work out a plan—the receivers could, through the cooperation of the officers and the directors—that would be satisfactory to the contract owners.

Q. You said that it was understood that the receivership would ultimately be shifted into the Federal Court.

A. That was never brought up for discussion at a directors' meeting to my knowledge or recollection, but in talking among ourselves, I got the impression, through counsel, that that would eventually possibly have to be done, for it was felt by some, and I felt so myself, that some State [fol. 1729] departments would not go along on any plan of that nature, that they would have to be pulled, and the only way it could be pulled would be perhaps through the Federal Court.

The Court:

Q. Mr. King, did you say you got that impression through counsel?

A. Well, in talking with Mr. Foulk, our general attorney up there, just casually—not formally, but casually.

Q. Did you ever talk to Mr. Koontz about it?

A. I believe I did. I think I——

Q. What was his idea?

A. That was his impression, that eventually we would have to perhaps go to the Federal Court with our plan worked out as far as we could get in the other courts or with the State departments—we would handle it that way.

Mr. Reinhardt:

Q. You testified that a large volume was prepared by Koontz and Koontz for filing with the Securities and Exchange Commission. Was that ever filed with the Commission, or do you know?

A. I don't think it was filed formally. I think it was given them informally to look over, is my recollection.

Q. Fidelity never sold any new contract after December [fols. 1730-1752] 31st 1940, did they?

A. Not to my knowledge.

Q. Do you know for what purpose that statement was prepared? Was it to comply with the Investment Company Act of 1940 or with some other statute?

A. It was prepared to comply with the Investment Act.

Q. Do you know that of your own knowledge, or is that just an impression that you got?

A. Well, I don't think there is any question that the statement, when we authorized the preparation of that statement, we felt that we would get in additional new capital that would enable us to qualify under the Investment Act. In the meantime, this amendment to the Investment Act, my recollection, was passed, which had something to do with it.

Q. Well, perhaps you and I were not using the same language. What you referred to as an amendment to the Investment Act is what I have referred to as the Investment Company Act of 1940.

A. Oh! I meant the original Act, and then the——

Q. That was another statute.

A. Oh, was it?

* * * * * * *

[fol. 1753] D. A. BURT, called as a witness by the debtor, having been duly sworn, testified as follows:

Direct examination.

By Mr. Ray:

Q. Have you been sworn?
A. Yes, sir.
Q. What is your name?
A. D. A. Burt.
Q. What is your age?
A. Sixty-four.
Q. Where do you reside?
A. Wheeling.
[fol. 1754] Q. What is your occupation?
A. I am a businessman.
Q. How long have you lived at Wheeling, West Virginia?
A. All my life except a few years when I lived in Steubenville, a nearby town.
Q. How long have you been engaged in business in West Virginia and other places?
A. Forty-seven or eight years.
Q. Are you now a director of any business corporation?
A. Yes, sir.
Q. Will you state what they are?
A. The Wheeling Steel Corporation, the Continental Roll and Steel Foundry Company, the Woodward Iron Company, of Birmingham, Alabama, the Fidelity Investment Association, the Jefferson Coal Company, one or two minor ones—Chesapeake and Potomac Telephone Company.
Q. Are you a director of the Fidelity Assurance Association?
A. Yes, sir.
Q. How long have you been associated with Fidelity Assurance Association and its predecessor, the Fidelity [fol. 1755] Investment Association?
A. I think since about 1920.
Q. Have you held any offices in that association?
A. I was a director and member of some of its committees, I think for a little while vice-president, and for seven years was president in the earlier history of the company.
Q. Do you recall the years in which you were president?
A. From 1923, I think, until 1930.

Q. From your association with the company, are you advised of the nature of its business and of its present condition?

A. I think so.

Q. Will you please state whether or not, in your opinion, based on your experience as a business man and on your knowledge of Fidelity Assurance Association, the association should be reorganized?

A. Yes——

Mr. Farmer: Just a minute, if the Court please. We object to that question whether or not it should be reorganized. The question is as to whether or not there is [fol. 1756] a reasonable chance of a fair and equitable reorganization.

The Court: This question could very readily lead up to that. I will overrule your objection.

A. Yes. I would like to qualify that, however, Mr. Ray.

Mr. Ray: Well, go ahead, Mr. Burt.

A. If all the parties in interest will stop quarrelling, so to speak, and join hands in an honest effort to protect the contract holders, I think the company can be reorganized.

Q. In your opinion, can this Fidelity Assurance Association be reorganized?

A. Yes.

Q. Do you care to state your reasons for your opinion that it can be reorganized?

A. The company, like all the other companies with which I am identified, lost considerable money at the time of the depression of '29 and '30. It had a very large portfolio, and naturally there was some depreciation in that portfolio. All of the other companies with which I have been identified are making money. One or two of them [fol. 1757] have gone through reorganizations, one of them under this same 77B and another one through voluntary reorganization. They have all gotten on their feet and are in a sound position today and all are making money except Fidelity. I think if the same judgment is used in reorganization Fidelity and, as I said, if all the interested parties will get together, it can undoubtedly be reorganized and made a going concern again, and the in-

terest of the contract holders will certainly be more protected and better protected in a reorganized company than in a liquidation.

The Court: Now, Mr. Burt, I would like for you to go a little further and give the Court a sort of outline of your ideas as to in what way the company should be reorganized. How would you go about it?

A. Well, if Your Honor please, I think, on account of the widespread business the company did in various parts of the United States, under various laws, that it is absolutely essential that one central court take custody, and I think that should be a federal court.

Mr. Farmer: We object to that answer and move that it be stricken. That is not responsive to the Court's ques- [fol. 1758] tion, the answer that one central court take custody. That has no relevancy on the question of how it can be reorganized.

The Court: I will overrule the objection. Go ahead, Mr. Burt.

A. It seems to me essential that a plan be obtained that will meet the approval of the SEC and of the Auditor of the State of West Virginia. The interests of the stockholders are secondary. I am a very large stockholder—that is, my family is probably the second largest stockholder in the company. I am not interested in that at all, and I am very definitely interested in seeing that these contract holders get all their money with the least possible overhead expense, and I think that can be done in a federal court. Does that answer you?

The Court: I would like for you to go a little further and say what type of organization you have in mind, when you say that you believe it can be done.

A. The first thing, of course, is to get a plan of such character that new capital can be obtained. If that plan is actuarily sound, and, as I said, meets the approval of [fol. 1759] the Securities and Exchange Commission and of the Auditor of this State, I think the capital can be found. If the general fund of the company is improved by the addition of a large amount of capital—and I admit that is a large amount—the contract holders are infinitely better off than they would be in the event of liquidation.

Q. Well, it is your idea that it should be continued as a face amount certificate company solely or some other form or a combination of more than one form of business?

A. I don't know, Your Honor. It would seem to me a committee on reorganization would have to work that problem out with the supervisory authorities. I understand some of them object to that type of contract. If that is the case, the contract would have to be so modified as to meet their desires.

Q. In view of the somewhat stringent requirements now of the Investment Company Act, do you believe that the reorganized company could be made attractive enough from an earnings viewpoint that new capital would seek to go into it?

[fol. 1760] A. Yes, I think the problem of earnings depends, of course, on interest rates. Interest rates generally are very low. Savings rates are almost non-existent in the territories with which I am familiar. Obviously, Fidelity's reserves will have to be figured on a rate that takes into consideration prevailing interest rates. If such rate is arrived at, there is no reason why the company should not conduct a profitable business. There is certainly need for thrift in America, and all Fidelity has been doing has been selling a plan—a thrift plan or a savings plan—to a rather thriftless people. Now, that may take the form of an annuity and income contract, and assurance contract. It may have in it some form of insurance. It may be all insurance. But there is a field there for systematic saving, and a saving that has a definite objective. The little notice that came to my desk once a month was a reminder to me that it was time to put a little bit of money away. It was a reminder to me; it was a reminder to many of their contract holders, that they should continue their savings, and that was what Fidelity was selling, a plan. I think the field is broad enough so [fol. 1761] that the company, even on a very small margin of profit on an individual unit, could operate on a sound basis. Does that answer your question?

The Court: Yes, that answers that question. Let me ask you this. The company heretofore has been operating with a larger permitted margin of profit, as I understand it, and yet it has now become insolvent to the extent of some two and a half million or more. Can you explain why that

would be and yet reasonable that with your statement now that a new company could make money?

A. Well, part of the reason is that for the last several years the company has been under tremendous expense in connection with litigation. I don't know what its litigation has cost in total, but I am informed somewhere between six and eight hundred thousand dollars. That expense, it seems to me, if a sound plan was adopted, would be unnecessary to the new company. A part of this loss occurred in the depreciation of the very large securities account back in '29 and '30. I think the securities account at that time ran over thirty millions, and there was prob-
[fols. 1762-1769] ably five or six million depreciation. That is not any greater relatively than many of the insurance companies and many of the banks had in their portfolio. That amount would have been recouped ere this time with the normal business that Fidelity was doing and without this rather abnormal expense, had Fidelity continued business as it was doing.

Q. It is your testimony, then, that aside from the extraordinary legal expenses and other similar expenses of the last two or three years that Fidelity has been on the upgrade since the great depression of 1932?

A. Yes, sir.

. . . . . .

[fol. 1770] Q. Mr. Burt, under these present contracts a person had to pay into the company for between six and eight years before they could ever hope to even get the money back without interest which they had put into the company by virtue of these contracts. Isn't that true?

A. I don't know the period, Mr. Palmer, but practically all insurance has that same situation.

Q. But in an insurance policy, if you die during the period your estate receives the face value. In this you get nothing back——

A. I think you are mistaken.

Q. In this you don't get your money back even until you pay for six or eight years. Now, is that something that is generally desired by the public, in your opinion?

[fol. 1771] Mr. Huwe: Your Honor, I object to that question on the ground that he is projecting into the future the specific terms of a contract of a face amount certificate company. In the first place, the reorganized company may

not be a face amount certificate company. In the second place, the terminology of the contract may be entirely different from the terms which he has projected into his question; and therefore, I think that we are going too far afield and that is not a competent question.

The Court: Overruled. You may answer.

(The last two questions were read.)

A. The contracts are sold with that understanding. I don't know about the six or eight years. I am not in close touch with that. They are sold with that understanding and the contract holder enters into his contract to make his monthly payments; so that if he takes his contract with that understanding I don't think there is any injustice done to anyone.

. . . . . .

[fol. 1772] Q. Isn't it true that if the public were fully advised that they could invest in either a savings back or a government bond and get their entire money back at any time, plus some small amount of interest, that they would not thereafter want to invest in something that would take them six or eight years to get their money back, the amount they put in it, without interest?

Mr. Ray: If it please Your Honor, we object to that, because in cross examining Mr. Young yesterday the same question was asked, and Mr. Young clearly pointed out to Mr. Palmer that the cost of carrying this contract for the contract holder, the cost of making these investments [fol. 1773] for him, the cost of working out this plan, is what the contractor paid for. There is no use going into it again.

The Court: Overruled. Go ahead.

Mr. Palmer: If Your Honor please, I think the remarks of counsel to one witness what another witness has said in the form of an objection should be striken from the record, and so ask.

The Court: Well, it is already in. If there has been any harm it is already done, so overruled.

A. I don't know how familiar you are with the contract that was sold, but it assumed a definite time, it assumed that the contract holder would do certain things, make monthly payments and so on. It delegated the company

to purchase securities, and those securities, generally speaking, were bought with the idea of maturing the contract at its maturity date, and not with the idea, except some of them for valdity, that these folks would all come in within six months or a year and get their money. It was a systematic savings plan which contemplated returning to a man his money with a profit at the end of the period if he continued his plan. It had loan values which were specifi- [fol. 1774] cally on the contract, and it had cash surrender values; it had certain death benefits; and the company had to maintain an investment staff, investment committee, depositories, and go through all the details of the management of a very large trust estate; and for that the contract holder had to pay, and those who continued according to their contract to the end always made money. Those who, like in many other instances, changed their mind half-way through, or something of that sort, naturally didn't make as much.

Mr. Palmer:

Q. Mr. Burt, did you know that the experience of the company as developed by the Securities and Exchange Commission, showed that only five per cent plus of the contract holders ever carried their contracts through to maturity?

A. That doesn't alter my answer.

Q. It doesn't?

A. No. The company's organization was there ready to carry through.

Q. Mr. Burt, first as to cash surrenders, if a man invested from one to five years in Fidelity and put an equal amount in either defense bonds or a savings account, at [fol. 1775] the end of the five years with either the bank or the United States Government he could receive his money that he paid in in full, plus interest. Isn't that true—if he wanted to quit?

A. Yes.

Q. With Fidelity, if he wanted to quit at the end of the five years, he would not receive in return even the money which he paid in. Isn't that true?

A. I don't know about the time.

Q. All right, sir.

A. But there is a very great difference between the Fidelity contract and a savings bank deposit.

Q. All right, sir. I would be glad to have you develop it.

A. They are made very definitely for different purposes. If a man has a bank account he takes it out, like we all do. If he wants insurance he takes that out. If he wants a systematic savings plan, he takes a Fidelity contract.

Q. Isn't the essential difference that with the systematic plan he can save exactly the same way with the bank——

A. But will he?

[fol. 1776] Q. (continuing) That he could with Fidelity, with the exception that Fidelity sends him a notice each month to pay and the bank doesn't?

A. Well, I will cite my own case. I had a savings account and I had some Fidelity contracts. I put in the savings bank if and when it was convenient, and very often I bought something and didn't put the money in the bank. As a consequence, the savings account didn't grow very much. But every month I got a little reminder on my desk that it was time for me to pay $10.00 or $7.50 into this Fidelity contract. My savings account never grew very much, but my Fidelity contracts did grow.

Q. If, in the case I have given you, at the end of five years you would get the money back in full from a savings bank, with interest, and at the end of five years you wouldn't even have got your moey back from Fidelity, wouldn't it have been much cheaper to have your secretary lay a little notice on your desk each month and say, "Mr. Burt, deposit so much in the savings bank", rather than to pay Fidelity when they wouldn't even give you your money back?

[fol. 1777] A. As a matter of fact, our contract holders, very few had secretaries.

Q. For a very reasonable amount wouldn't your secretary or anyone else's be glad to mail them a notice to deposit in a savings bank?

The Court: I think that question has gone far enough. It is not so much a question of reminder as a question of compulsion on the part of the contract holder to pay or lose what he had paid, so there is another element besides reminder.

Mr. Palmer: All right, Your Honor.

Q. Now, Let's look at the loan value you are talking about. If a man pays into a savings bank a thousand dol-

lars and any time he wants to use his own money he can take that money out. Isn't that correct?

A. If the bank is solvent, yes.

Q. Yes, if the bank is solvent. If a man pays into Fidelity a thousand dollars he can take his own money out provided he pays Fidelity six per cent for doing it. Isn't that right?

A. The Fidelity tables are based on actuarial calculations by the best actuaries in the country, and are somewhat [fol. 1778] similar to insurance tables. I am not going to go into the details of the actuarial tables of Fidelity.

Q. My question is this, if a man had a thousand dollars that he deposited in a savings bank, and he wanted to use his own thousand dollars, which he was going to pay back in two or three years, he could do that without any charge of interest; but if, on the contrary, he had a thousand dollars in Fidelity and wanted to use his own thousand dollars and he was going to pay it back in three or four years, he would have to pay Fidelity six per cent for the use of his own thousand dollars, wouldn't he?

A. The difference is this. When a man put his money in a savings bank he made one type of contract. When he put it in Fidelity he made a different type of contract.

Q. I agree with you, but my question is that that is true that I asked you, is it not?

A. I don't know.

Q. You have spoken of the possibility of new capital being attracted to Fidelity. There is evidence here that [fol. 1779] there was a high turnover in salesmen, and an example is cited. In the year 1936 there were six hundred and thirty-four salesmen at the beginning of the year, there were eleven hundred and eighty-two new salesmen hired during the year, and one thousand and fifty left the employment of the company during that year—quoting from page 88. With such a high turnover of salesmen, does it not indicate that the article being sold was very difficult to sell?

A. In what year was that?

Mr. Ray: May it please Your Honor, that is certainly objectionable.

The Court: I will sustain the objection to that question. That question is entirely argumentative, and so are many of the others that have been asked this witness.

Mr. Palmer: I expect Your Honor is correct in that, and I will not insist on it further.

The Court: Those matters may be used in argument, but I don't think it is proper in your question.

Mr. Palmer: Your Honor is probably right.

Q. Mr. Burt, let me ask you this. If Fidelity had to [fol. 1780] spend large amounts to sell the contracts which it was selling, with the rate of improvement to reserve which it then offered, would it not have to spend a larger amount to sell another face amount annuity contract in which the reserve would be improved at a much lower rate, in your opinion?

A. No, I don't think that is necessarily true. Interest rates on everything are going down, as I said, and it is only natural that interest rates on the Fidelity contract, whatever type it becomes, will go down. The relative return is the thing that counts. If you get a half of one per cent from a savings bank and get one per cent from Fidelity, you are better off with Fidelity, if Fidelity is well managed.

Q. My point is this, Mr. Burt. I think your answer has given me partially the answer that I want, but you are not prepared to say, are you, that Fidelity should again engage in the selling of face amount certificates as a sole business?

A. I won't answer that. That is a matter for the committee and the SEC and the Auditor to work out.

Q. And I say, you are not prepared to say that, in your [fol. 1781] your opinion, it should engage in that business alone, are you?

A. Not without a great deal of study.

Q. Which you have not——

A. Which I have not made.

Q. Did you know, Mr. Burt, that Fidelity had formulated, during the latter part of 1940 and the early part of 1941, a number of various plans to submit to contract holders, so that it could go along as a going business?

A. I knew nothing of that. I was not on the reorganization committee.

Q. Did you know that Fidelity had worked on that idea?

A. I knew there was a committee appointed and they were supposed to be at work. They never reported to the board, and I didn't know what they had done.

Q. But you knew there was a committee supposed to be working on that idea?

A. No, I don't know what idea they were working on. They were working on a plan for reorganization.

Q. Yes. That was what I meant. And you don't know what work that committee did?

[fol. 1782] A. No.

Q. Now, Mr. Burt, would this be fair to state, that it is your opinion that there is in the investment field room for a company which will aid persons who will contract with that company in making periodic and systematic savings?

A. Yes.

Q. And it is your idea, is it not, that the value—one of the principal values of the company, of course excluding the fact of good management and safety in investment—is that it will give notice to each contract holder or person who contracts with the company periodically of the time to make their next payment. That is one of the principal features, is it not?

A. It is a systematic savings plan, and I think that monthly notice is of some value, yes.

Q. And the systematic savings, that is, savings at regular intervals, is an added value in that field. Isn't that your idea?

A. That is a part of the service that the company renders; not all; that is just a part.

[fol. 1783] Q. That is what I say. And it is your idea, is it not, that the systematic savings is the idea which Fidelity has as one of its main ideas which should be preserved through some form of rehabilitation satisfactory to the ones connected with it.

A. That was the idea of the founder of Fidelity, who was a banker and also an insurance man, that some form of systematic saving was desirable for the American people, if I may use that broad term; and I think the management, as long as I was active in it, followed that idea of Mr. Paull's.

Q. And that really the fact that the amount of interest that people get, or that they may have loan values and so forth, is secondary to that main idea of the savings plan, systematically carried out by the contract holder. Isn't that true, Mr. Burt?

A. I would put the systematic savings first; and the financial results, naturally, must be equitable, and the company's

earnings must be based upon a fair compensation for the services which it renders.

Q. That is why, when I was asking you about savings banks, the mere fact of saving, of having your money held, [fol. 1784] can be done in any one of a number of ways, but Fidelity is the only one, or the largest one which has carried through and carried out the plan of systematic savings by those that would contract with it. Isn't that correct?

A. I wouldn't say it was the largest one. It is one of them, and as I repeated two or three times, I think there is a field for that type of systematic savings in a country that is notably extravagent. It won't hurt them to save, and save systematically.

Q. And it is your present thought that this present company can be rehabilitated into some form of company satisfactory to the various state and federal officers so that that idea can be carried on and perpetuated. Isn't that true?

A. Well, I have already answered that, and I have qualified it. I think it can be done, and I think it should be done.

Mr. Palmer: That is all the cross-examination I have, Your Honor.

The Court: Make it as brief as possible, Mr. Farmer. We are lagging some.

[fol. 1785] Cross-examination.

By Mr. Farmer:

Q. Mr. Burt, you have expressed your opinion as to the desirability of some reorganization of this company. I take it that you would agree with me that just a general disposition of persons connected with the company and others who sympathize with it in its present distress would not warrant delaying the contract holders who at the present time have their money in the company from getting their money out, unless there is a good, fair chance at present of a reorganization that will be approved.

A. I think that would be a matter for the court who took custody to rule on.

Q. I guess you would agree with me also in this, Mr. Burt, that the question of whether or not a company can be organized with a reasonable chance of successful operation under the present laws, particularly the Federal Investment Company Act, as a new company, is rather far removed from the present problem that this Court is dealing

with, that is, this company that is now in financial difficulties?

[fol. 1786] A. I don't believe I know just what you are driving at.

Q. I say, the question of whether you can organize a new company that is likely to succeed—an entirely new company, with new capital, starting out fresh, is a distinct question from the question of whether this company can be reorganized.

A. Yes, I answered that I thought this company could be organized. Does that answer you?

Q. You answered, I believe, as I understood you, that you thought the present common stockholders ought to have some equities in the new company.

A. Merely future earnings, if there are any.

Q. Sir?

A. Merely future earnings, if there are any.

Q. What form would those equities take that you have in mind?

A. Might take the form of——

Q. I can't hear you, Mr. Burt.

A. I don't know whether the Investment Act would permit it or not, but I would think a no-par security of some sort.

[fol. 1787] Q. Voting rights?

A. Yes.

Q. Voting rights. Will you speak out just a little bit louder. It seems to me like I am a little hard of hearing. Have you gone into the situation and are you familiar with the situation of this company with respect to deposits of securities in the different states——

A. No.

Q. (Continuing:) Securing these contracts?

A. No.

Q. Sir?

A. No.

Q. Did you say that you became a director of the company in the spring of this year again?

A. Yes.

Q. And you had not been a director for about two years?

A. Prior to that.

Q. About two years previously you had been; and then became again this spring?

A. Yes.

[fol. 1788] Q. Are you aware of the fact that approximately ten million dollars of the assets of this company are at the present time being held by state officials in states other than the State of West Virginia under laws of those states requiring deposits for the protection of contract holders in those states?

A. I don't know anything about the amount. I know there are some deposits in other states.

Q. You didn't know that there was as much as ten million dollars held in other states than West Virginia?

A. I did not.

Q. Did you know that about ten million dollars of the assets and securities of this company were, at the time the petition was filed or the present time, in the hands of the Treasurer of the State of West Virginia for the protection of contract holders who put their money in this company?

A. I didn't know the amount. I knew there was a large amount down here. After all, you know, we have committees and officials and auditors, and we have lawyers, so that the technical details of the business as they affect those different groups are in their charge, and as a director [fol. 1789] I assumed that the deposits that were being made were in accordance with the laws of the various states and in the proper amounts, and I don't know whether that was five hundred thousand or three hundred thousand or seven hundred thousand in any one place, and I didn't think it was my duty, as a director, to inquire into that when we had specialists there to do that work.

Q. As I understood, you, you thought some committee could be appointed that would get up a plan that would meet with the approval of the Court and the approval of the Securities and Exchange Commission. I didn't hear you in your answer give any recognition to the necessity of getting the approval of two-thirds of the creditors, including secured contract holders that are secured by these deposits and getting their approval of a plan of reorganization. Did you have that in mind that that would be necessary in this court?

A. Yes, I have that in mind.

Q. You just overlooked mentioning that in your answer.

A. No. Naturally any plan that meets with the approval [fol. 1790] of the reorganization committee and the Audi-

tor of this State and the SEC will receive very favorable consideration by the contract holders.

Q. Now, suppose, Mr. Burt, that under the laws of some twelve states other than the State of West Virginia there are, as I have put in my previous question, about ten million dollars of these assets being held to secure the liabilities of this company to contract holders who have their money in it, would you think that a plan that involved the cutting down or reducing of the claims of those contract holders—those secured contract holders—in those deposited funds would likely meet with their approval?

A. There again you are getting back to the plan. Now, I am not going to discuss the plan. That plan will have to be worked out by a committee, and it will have to meet the situation, and if it is approved, as I said, I think the contract holders in all the states will be so glad to have it, rather than a liquidation, that more than sixty-six and two-thirds per cent will approve it.

Q. I understand that you would agree with me that in [fol. 1791] forming an opinion as to the reasonableness and the prospect of a plan of reorganization, that we have to weigh the present situation with which we are dealing with respect to the assets of the company and how the assets are held.

A. The committee will do that.

Q. You mean that you don't think that you should do that in expressing an opinion as to whether or not there should be a reorganization?

A. No, I don't think so. This plan is in the air yet; it is not formulated; it depends on a great many factors, including state laws and national laws and the approval of supervisory boards, and I am not going to attempt to make a plan on this witness stand.

Q. I think you recognized that there was a need for a considerable amount of new capital?

A. Yes.

Q. How much new capital do you think would be needed?

A. I don't know. It changes from time to time; our securities list is up and down. We are at the moment in an advancing market. As soon as this tax bill is finally passed, investment funds will probably come out. There is a rea- [fol. 1792] sonable hope, at least, that securities will sell higher in six months than they are doing today. The port-

folio might appreciate somewhat. I don't know what this committee might face.

Q. Do you know at the present time how much the deficiency is——.

A. I do not.

Q. Well, wait. You haven't heard my question.

A. Pardon me.

Q. Do you know at the present time how much the deficiency is between the reserves—invested reserves—and assets of the company—on the outstanding contracts—and the cash liabilities or reserve liabilities of the contract holder.

A. I do not.

Q. Sir?

A. I do not.

Q. You didn't know that that was about at least as much as $2,600,000?

A. I did not. I understand——

Q. In your opinion, would there be a fair chance of reorganization, of getting the approval of the Auditor of the [fol. 1793] State of West Virginia and the Securities and Exchange Commission and two-thirds of these contract holders—these secured contract holders—to a plan of reorganization that did not bring up these reserves to the liabilities of the company, reorganizing it as a solvent company?

A. There is again your plan. You are trying to get me to discuss the plan, which I will not discuss.

Q. Then you recognize that there is a problem of getting the new capital?

A. Certainly.

Q. Do you think that anybody would want to invest his money—any prudent business man—in putting in two or three or four million dollars in a company if that is the situation, if there is that deficiency of $2,600,000 between reserves and liability?

The Court: Mr. Farmer, there is no intimation that anybody will ever have to do that, or that anybody will be foolish enough to do that, so let's ask reasonable questions.

Mr. Farmer: If the Court please, I believe that is reasonable.

[fol. 1794] The Court: I don't.

Mr. Farmer:

Q. Wouldn't that either have to be done or wouldn't you have to bring your liabilities down to your assets?

The Court: We all know nobody is going to give this company two and a half million dollars to make up its deficit. Why ask a question that involves such an unreasonable thing as that?

Mr. Farmer: We also know, if the Court please, that nobody would reorganize it except as a solvent company.

The Court: That involves a lot of considerations, such as ascertaining just what the rights of the contract holders are and if their rights have already been depreciated to the extent of two and a half million there is no argument that I can see that they would expect that to be increased.

Mr. Farmer: Then there would be only one way to do it, and that would be to bring liabilities down to assets, wouldn't it?

The Court: Perhaps so. I do not object to you developing whatever you please, only please don't go into any [fols. 1795-1811] unreasonable and chimerical series of questions. Confine yourself to the practical aspect of this question.

Mr. Farmer: I submit, if the Court please, that is the most practical question we have got.

The Court: You know nobody is going to put in two and a half million dollars or give it to this company.

Mr. Farmer: Yes, sir.

The Court: You know that nobody in this room thinks that anybody would do that.

Mr. Farmer: Yes, sir.

The Court: Why ask the question, then, of this witness?

Mr. Farmer: And I also think that the contract holders aren't going to contribute it by voluntarily reducing their claims on the assets.

The Court: You can argue that, but don't go into it with this witness.

Mr. Farmer: I just wanted to test out the basis of his opinion of the desirability of reorganization.

. . . . . .

[fol. 1812] Q. All right, sir. You said one time you bought a contract, and you liked the way you got these notices.

[fol. 1813] A. Yes.

Q. Did you own any contract at the time this company went into receivership?

A. I don't know.

Q. Sir?

A. I don't know.

Q. When was the last time you held a contract?

A. I don't know that.

Q. Can you look that up and tell us?

A. I don't know whether I can or not.

Q. How much did you ever hold?

(No answer.)

Q. Well, I will ask you to do this. I see you are pausing——

A. I don't know. I had several contracts. Some I bought for my children and some for Mrs. Burt, but I can't tell when I bought them or what I paid on them.

Q. I want to ask you to do this, please, sir. During the noon hour, to look up the information and then give it to us after lunch, the dates and amounts of all the contracts that you or any member of the family of you bought and [fol. 1814] the dates when you cashed them in, if you cashed them in.

Mr. Ray: Your Honor, that is an unreasonable request. Mr. Burt lives in Wheeling. Undoubtedly all his records are at Wheeling; and I don't think those things have any place in this case at all.

Mr. Farmer: Could you get that for us, Mr. Burt?

The Court: Mr. Farmer, that would have pertinency only to the extent whether Mr. Burt owned any contract at the time of the receivership, and possibly whether he had cashed in any contracts before their maturity prior to the receivership. If you will confine it to that, I will admit it.

Mr. Farmer: I had in mind, if the Court please, it was a very practical test of his faith in this sort of savings institution.

The Witness: Not necessarily.

Mr. Farmer: I just thought that would be some test.

The Witness: Not necessarily. I might have needed some money.

Mr. Farmer: Well, can you get that information for us, Mr. Burt?

[fols. 1815-1819] A. I don't think I can.

* * * * * * *

[fol. 1820] Q. Mr. Burt, all these parties in interest that you thought should get together on this, have you considered the various state authorities such as the Banking Commission of Wisconsin and the authorities of the twenty-nine states in which this company was licensed to do business?

A. Not particularly.

Q. Why have you not considered them?

A. I think the federal court would handle this thing very much better than the rather selfish interests of the various states. Each state has its own interests and is not [fol. 1821] particularly interested in the other states nor in the contract holders as a body.

Q. Let's go into that a bit. Are you familiar with the nature of the laws under which the company operated in Wisconsin?

A. I am not a lawyer.

Q. You know they had a deposit out there?

A. Yes, sir.

Q. And did you know that that deposit was supposed to secure the payment of those contract liabilities in full out there?

A. I didn't know what percentage they deposited out there. I say I am not a lawyer.

Q. Mr. Burt, when you talked about some selfishness existing out in the states, did you refer to the contract holders or to state authorities who are attempting to protect the contract holders in their various states?

A. I think some of the states are trying to grab off assets of this company in excess of their requirements.

Q. Will you explain that further? I don't understand it.

[fol. 1822] A. Well, some of the states probably have, at the market values today, deposited with them more money than will be needed to carry out the contracts in those states.

Q. And who do you think is trying to grab off anything——

Mr. T. C. Townsend: Let him answer. I don't think he finished his answer.

The Witness: In the interests of all the contract holders, I don't think any state should be permitted to appropriate unto itself and its contract holders money in excess of the amount required to satisfy the claims in that state.

Mr. Lauritzen: Yes, now if there is an excess in any state, just who is it that you have an idea is trying to appropriate that excess? Is it the state as a body or some individual in those states?

A. My reason for preferring the federal court——

Mr. Lauritzen: Just a minute. Read the question, please.

(The question was read.)

[fol. 1823] A. The funds have been tied up, as I understand it, in some of the states.

Q. Yes, sir.

A. They are out of the control of the company, and at the moment, if state procedure continues will be under the control of those states. That might end to the detriment of all the contract holders, because of the fact that much of the excess would be—I won't use the word "wasted", but would be used in litigation of various sorts in those states in the state courts; and the one thing from which this company has suffered more than anything else in the last four or five years has been continued and expensive litigation. The directors and officers of this company have worked for a mere pittance, but the legal fees we have had have simply been outrageous; but if they have proceedings in twenty-nine states there is no hope whatever of reorganization and the contract holders' money will be gradually frittered away.

Q. You believe in the obligation of contracts, I think, don't you?

A. Yes, sir.

[fol. 1824] Q. As a businessman and director of various corporations?

(No answer.)

Q. When you buy something from a company you like to see the deal carried through per agreement, don't you?

A. Certainly.

Q. Are you familiar with the fact that out in Wisconsin and other states these contracts were sold on the repre-

sentation that there was a law in those states, which in the event of default of these contracts, would go into operation and permit liquidation of those funds under state authority and the payment to the contract holders of the value of their contracts?

A. I don't know on what basis they were sold out there.

Q. Well, if I told you that that was the basis that they were sold on, you would believe that it was reasonable to believe that that was the basis they were sold on, wouldn't you?

A. I don't know. We had a thousand salesmen out selling these contracts. I don't know on what basis they [fol. 1825] sold them.

Q. As an officer and director of this company, did you feel it your duty to ascertain what representations were being made to purchasers of these contracts?

A. We had a regularly organized company to look after those sales. We had a regular organization to do that work.

Q. Yes, and they were doing it on your behalf, weren't they?

A. They were doing it on behalf of the corporation.

Q. Of Fidelity, yes. Didn't you deem it encumbent upon you to look into those sales methods?

A. Of course we did.

Q. You knew they were operating under deposit laws in various states?

A. Certainly.

Q. And you knew they were representing to purchasers regarding the existence of those laws, didn't you?

A. We didn't make the sales. I didn't present a contract to a single soul. I don't know what the salesmen told them.

Q. If I told you that the salesmen did tell them that [fol. 1826] would you believe me?

A. I still don't know.

Mr. Ray: Your Honor, that is not pertinent.

The Court: No, I know of nothing in this record to base that on.

Mr. Lauritzen:

Q. Mr. Burt, if you were a contract holder out in Wisconsin and you had a Wisconsin law to protect you which formed the basis or part of the basis of your agreement

with Fidelity, and this company went insolvent, you would be quite interested to see that law enforced, wouldn't you?

Mr. Ray: Your Honor, that is an obvious question.

The Court: What is the question?

(The first part of the question was read as follows: "Mr. Burt, if you were a contract holder out in Wisconsin" * * *)

The Court: I will sustain the objection.

Mr. Lauritzen: When you talk about states grabbing off excess, do you mean that there are some lawyers out in those states who are seeking fees in liquidation proceedings out there?

A. I mean that if this estate, whatever you choose to [fol. 1827] call it, of some twenty-odd million dollars, is administered in twenty-nine states, a large part of the assets will be wasted in a duplication of legal cases and so on, and there will be undoubtedly—I wouldn't say it about any lawyer in this room, but there would undoubtedly be lawyers who will take advantage of the situation in order to fatten their own purses.

Q. Let me call your attention to the fact that there are deposits in only fifteen states instead of twenty-nine.

A. There are still plenty left.

Q. Are you familiar with the fact that in the State of Wisconsin, Ohio, and numerous other states having deposits the legal proceedings are being handled by the offices of the respective attorneys general of those states?

A. Up until this time, is that the case?

Q. I am asking you whether you are familiar with that fact.

A. No, I am not.

Q. If you were familiar with that one fact and knew the state officials were acting to the best of their ability [fol. 1828] to protect their people, it would change your answer as to such a state, that there was going to be any wastage.

Mr. Ray: Objected to as purely argumentative.

The Court: Sustained. I know of nothing in the evidence to sustain that.

Mr. Lauritzen: Your Honor, the appearance of counsel in this case shows clearly that the attorneys general of

all the various states are representing the state authorities out there in proceedings brought for the benefit of those contract holders.

The Court: It shows just what it shows on the record, that you are appearing here for them.

Mr. Palmer: Your Honor, May I suggest that the various state laws, the Court takes judicial notice of those, the laws of the various states which make what provision, that the state officials, by virtue of their salaries and by virtue of their election to the positions which they hold, shall take charge of it; and while the state statutes are not in evidence, yet I believe the Court will take judicial knowledge of the statutes of all states, and therefore the [fol 1829] question would be proper.

Mr. Huwe: Your Honor, I wonder if Mr. Thomas and Mr. H. Isaiah Smith are going to serve without fees in this West Virginia matter, and that whether that is a very relevant consideration in this case.

Mr. Lauritzen: Mr. Huwe, my question was directed to those states in which the attorneys general were handling the proceedings on behalf of the contract holders and acting under the state statutes.

Mr. Huwe: I realize that the three states you speak of have complete machinery for liquidating and that they do not appoint outside receivers. Ohio can liquidate without appointing an outside receiver—I can't speak for any other state, but I know they can liquidate, because that was decided by a cross petition filed by Mr. Rivers in a state case, and I think they convinced us thoroughly that they have exclusive machinery; but that does not apply to Mr. Palmer's statement, and I think his statement should be refuted.

The Court: Suspend just a minute, please.

(There was a pause in the proceeding.)

[fol. 1830] Mr. Lauritzen: May I have the question?

(The question was read.)

Mr. Palmer: I think there was an objection to that question that was sustained, Your Honor.

The Court: I will let him answer the question to save time.

A. I tried to cover that in a general statement.

Mr. Lauritzen:

Q. I want you to be specific, in view of my last question.

A. I have no feeling that the attorneys general of the various states would waste any money if that is what you mean. I am not afraid of that, but I am afraid of other proceedings that might arise under the state laws of various states. Fidelity formerly dealt with the states until the passage of the Securities and Exchange Act and since then——

Q. Just a moment, Mr.——

The Court: Let him finish his answer, and then you can ask the question.

Mr. Lauritzen: I just wondered if he is not referring to the wrong law.

The Witness: You mean the more recent Investment [fol. 1831] Act?

Mr. Lauritzen: Yes.

A. At any rate, the SEC first assumed jurisdiction over Fidelity under the old law and brought proceedings against it. Now, of necessity, Fidelity must deal from now on with the United States Government as well as the states, and for that reason as well as the one I stated a while ago, I think it would be very wasteful to have a multiplicity of legal proceedings in all these states. There are only three states which are represented out of the fifteen, are there not, here?

Mr. Lauritzen: Oh, no, sir, Illinois, Ohio, Wisconsin, Tennessee——

The Witness: Four.

Mr. Lauritzen: Missouri, Kansas.

The Court: I understand Mr. Burt is inquiring how many states are represented here by attorneys general only. He says there are three. I think he has the right to ask you.

Mr. Lauritzen: Then I will tell him if I can.

The Court: All right.

Mr. Lauritzen: Wisconsin, Illinois, Ohio, Kansas.

[fol. 1832] The Court: Who represents Kansas?

Mr. Lauritzen: Mr. Swarmer.

The Court: Where is he?

Mr. Lauritzen: He has not appeared at the resumption of this hearing, but he has his pleading-in and he is an officer of the state.

The Court: All right; go ahead.

Mr. Lauritzen: Auditor Sims and Mr. Meadows of West Virginia, representing the West Virginia State Auditor; Iowa represented by myself at this hearing at no charge to the State of Iowa; Pennsylvania was here represented by an assistant attorney general.

The Court: Can you assure this witness in connection with your questions that there will be no charges to the fund in any of those states?

Mr. Lauritzen: No charges for legal services so far as I know.

The Court: Or receivers?

Mr. Lauritzen: In some states I understand they have receivers. In our state the Banking Commissioner of Wisconsin administers the fund.

The Court: The point is, is there to be any charge what-
[fol. 1833] ever in those states for expenses of liquidation?

Mr. Lauritzen: For expenses, yes, sir; for fees, no.

The Court: In any of the states you mentioned?

Mr. Lauritzen: I am afraid I couldn't answer that.

The Court: Then why ask the witness a question based on that when you yourself don't know it?

Mr. Lauritzen: Can't I ask him with respect to a state where I do know the situation?

The Court: Yes, sir, and in connection with your question I want you to give your assurance to this witness that there will be no fees whatsoever of the kind he has in mind.

Mr. Lauritzen:

Q. What sort of fees do you have in mind, Mr. Burt?

A. It was testified here yesterday, I think, that we paid $48,000 in legal fees in a proceeding. The point I mention, the legal fees and the court costs and the things that go with continued litigation are draining this company of its assets, much to the detriment of the contract holders. You have mentioned probably ten states that are right
[fol. 1834] here in this room. There are others that are not. Now, if we are to get anywhere with the rehabilitation of this company and the protection of the contract holders, there must be some central authority in control of it.

Q. You don't know whether the state authorities agree with you on that?

A. I would expect them not to.

Q. Do you have any idea whether they are acting in bad faith with respect to their sworn duty and their duty to the contract holders in their states?

A. I think the attorneys general undoubtedly are acting in good faith, but that won't estop other suits in those states.

Q. And it wouldn't stop any suits here, would it?

(No answer.)

Q. There are eighty thousand contract holders, and I take it all of them would have to be represented here either by committee or personally.

A. No, I think if the case was placed in the federal court the contract holders would feel it was in proper hands and probably not bring any scattered litigation, all over the country. If we have to defend ourselves in all the twenty-[fols. 1835-1871] odd states in which we do business, the contract holders' money will certainly be much less than if we handle it through the federal court alone.

* * * * * * *

[fols. 1872-1877] JOHN MARSHALL, SR., called as a witness, testified as follows:

Cross examination.

* * * * * * *

[fol. 1878] The Court: I understood he said he had received some personal communication from the Securities and Exchange Commission.

The Witness: The point I was trying to make was that I had given this information in respect to this letter to the meeting, which I did; and other directors can testify on that. That was the point I was driving at. I didn't know the attitude of the Commission at our first directors' meeting. That was one of the things that was discussed. That was one of the reasons that actuated me in what might be called a change of front.

[fol. 1879] Mr. Palmer: That is why we think it is important, Your Honor——

The Witness: Even if I lied about the letter, I did it at the meeting.

Mr. Farmer: What did you say about lying about the letter?

The Witness: I say even if I didn't receive the letter I told the meeting I had. That was the point I was trying to make. That was one of the things that influenced the decision at that meeting.

The Court: I think it is proper for the Court to see the letter in view of the various statements made.

The Witness: I would be interested in having Mr. Palmer, if the Court thought it proper, tell who gave him the information, because I think it would throw a very interesting sidelight on this proceeding.

Mr. Farmer: I think that is an extraordinary requirement on the part of the witness.

The Witness: There is certain information I understand attorneys receive which is confidential, and I am sure I can guess who gave Mr. Palmer the information, and I think [fols. 1880-1881] he would be greatly embarrassed in telling it.

* * * * * * *

[fol. 1882] Howard E. Reed, called as witness by the debtor, having been duly sworn, testified as follows:

Direct examination.

By Mr. Ray:

Q. Please state your name.
A. Howard E. Reed.
Q. Your age?
A. Fifty-six.
Q. Where do you live?
A. In Dormont, Pennsylvania.
Q. What is your occupation?
[fol. 1883] A. I am a public speaker.
Q. In what business have you engaged in the past?
A. I have been with the Fidelity Investment Association and the Fidelity Assurance Association and the Fidel Association of New York as an officer and representative of the field organization.
Q. Previous to your association with Fidelity were you connected with any other business enterprises or banks?
A. I was vice-president of the Union Trust Company of Pittsburgh, Pittsburgh correspondent of the Guaranty

Trust Company of New York, and assistant cashier of the Union National Bank of Pittsburgh.

Q. How long were you associated with the Fidelity company?

A. Since November, 1923.

Q. What offices, if any, have you held with Fidelity?

A. My only office has been vice-president in charge of bank and public relations.

Q. Are you now a director?

A. Yes, sir.

Q. How long have you been on the board of directors?

[fol. 1884] A. I was on the board for a few years and then back, I would say from '28—from '26 to 1929, and then I was asked to resign and reelected to the board about 1937.

Q. I believe you stated that you represented the field organization of Fidelity. Just what do you mean by the field organization?

A. I was the contact for the home office in the field, representing most times the vice-president in charge of sales.

Q. Will you state briefly just what duties you performed?

A. My main duties were to visit those offices which were not being satisfactorily operated, contacting the supervisors, managers and men, calling upon the Better Business Bureaus, Chambers of Commerce, banks and banking organizations.

Q. What, in your opinion, have been the chief difficulties of Fidelity during the past two years?

A. Well, I think that Fidelity has—the board of directors recognized that we had three problems. First, we had an agency note amounting to in excess of a million [fol. 1885] one hundred thousand dollars and we recognized this by taking from the stockholders' or general account enough money to reduce it to $750,000, and had we continued at the normal pace it was the intention of the board to ultimately retire that note. In addition, we recognized the condition of the special income reserve. Under a previous administration the securities in that reserve had been sold, and it gave us very little with which to work. Recognizing the difficulties in connection with that reserve, we took from the stockholders' account a considerable sum of money and placed in that reserve, and it was the object of the board of directors to continue to deposit funds in that reserve until such time as it would be solvent.

We recognized that we had outstanding some twenty or twenty-five million dollars of contracts on which the reserve basis was four and four and one-half per cent. Many of those contracts were sold during a period when Armstrong Cork Sevens, American Rolling Mills sixes, Aluminum Company's sevens, Gulf Oil sevens were offered on the market; and when we found that good bonds were [fol. 1886] selling on a basis yielding three and three and a quarter per cent our problem has been how best to meet a situation where the reserve is four and four and a half, when we can only realize three to three and a half per cent on our security values. However, it must be taken into consideration that we did earn on ten to twenty percent of the reserve approximately six per cent on loans to contract owners in those reserves, which did assist us greatly in building up the reserve for the assumed interest rate.

Q. During the last four years in which the company sold contracts, will you state how much per month the business increased?

A. I couldn't tell you how much per month, but when the sales organization was put in the charge of Mr. Evans, the vice-president in charge of agencies, I believe the volume—and it could be checked in the records—was approximately $700,000 per month. That grew until December, 1938, when the volume was on the basis of about $5,250,000 per month, and based on that volume our earnings would have shown a substantial increase—our operating earnings during 1939 and 1940. I estimate that the earnings would [fol. 1887] have been in 1941 between $500,000 and $750,000 on straight operations.

Q. That is inclusive of income on securities?

A. That did not—except those securities in the capital account.

Q. During the latter part of this period about which you have just testified, please state whether the sales organization operated at a profit or at a loss.

A. In 1935 and 6 the sales agency was operating at a loss of I would say approximately $100,000 a year, but by 1938 the sales agency was operating at a profit. I don't remember what the figures were, but I should say in 1938 the sales agency operated at a profit of $6,000.

Q. There has been some discussion here of turnover in sales representatives of Fidelity. What have you to say with regard to that?

A. Well, I think any sales organization such as ours—any specialty sales organization—has a large turnover. I have myself interviewed thousands of men. They may be fine appearing, they may have satisfactory educational, [fol. 1888] cultural and business background, and may look like successful men; but we have never yet found the prescription that would make them work, and unless they work they fail in our business, as they would fail in any business: and the turnover is due primarily to the fact that the most difficult thing in our business was to get people to work.

Q. Do you have any figures which would compare the turnover in the sales force with the turnover in the sales force of insurance companies?

A. I think they parallel. Of course, some insurance companies have recently adopted a plan of giving their men more and better training. I am happy to say that under the direction of Mr. Pulfer that was his objective. Our objective was to do everything we could to cut down the turnover, because the turnover is expensive. Every man that is recruited costs you a considerable amount of money, and we wanted to have a sales organization more stable; and we could do that because we had a problem in 1936 which was not similar to the problem we had in 1940. In 1936 we were showing a loss of approximately $100,000 a year. We had to do something and do it fast; and we [fol. 1889] built our sales organization as rapidly as we could. That meant fifty thousand miles a year travel for some of us while the hard work was being done, but we felt that we had reached the point where we could have some stabilization of our sales organization, and it was Mr. Pulfer's objective to do that, and he could submit to you many bulletins and letters that he wrote on that subject, Mr. Pulfer having been elected vice-president in charge of sales in April, 1940.

Q. It has been stated here today, Mr. Reed, that annuity contracts are no longer being sold by insurance companies. Do you know whether that is true or not?

A. Well, I know that they are being sold. Only week before last I was in Cleveland and contacted one of my former supervisors, Allen W. Carpenter. He is selling annuity contracts for the Franklin Life Insurance Company of Springfield, Illinois, a company in business some

forty-six years. One of our men formerly in business in Charleston sold annuity contracts for the Equitable Insurance Company of Iowa. One of our managers in New York is selling for the Columbia Life Insurance Company of Boston, Massachusetts, a very good company, because [fol. 1890] it is operating in New York state, which is the barometer.

Q. What have you to say with respect to the opportunities which Fidelity would have had to sell life insurance in addition to the special income contracts if it had been permitted to proceed?

A. Of course, I don't think there is any question but that it could have sold both life insurance and income reserve contracts. It was my duty to contact men in the field, and many of them were in almost daily communication with me, ready to start out in the field and demonstrate that they could be sold. As a matter of fact, they are being sold today by the Investors Syndicate, by these insurance companies, the Franklin Life Insurance Company—they just finished the best six months in their history, according to the statement which I received from them just a few days ago; and as I say, the proof of the pudding is the eating thereof.

Q. Will you tell us a little bit more about the business done by the Franklin Life Insurance Company during this past six months?

A. I couldn't possibly give you the figures.

Q. No, I mean the character——

[fol. 1891] A. Oh! well, they do a general life insurance business and they sell an annuity contract in which the payments are paid in for six years and then the annuities begin six years later, with cash surrender values, I believe, at the end of two years—beginning at the end of two years. I am not very familiar with terms of the contract, but I know those are some of the high spots.

Q. Mr. Reed, from your business experience in the past and from your knowledge of Fidelity and the character of its business, will you state whether or not, in your opinion, a plan of reorganization of Fidelity can be developed which will be practical and feasible?

A. I think it can.

Q. Do you care to make any statement of your reasons for your answer?

A. Well, of course my reasons are purely from the sales standpoint. I think that there is a great field in this country for an income contract—an income reserve contract. I don't believe that we have scratched the surface in sys-
[fol. 1892] tematic saving in this country. We are today reputed to be the greatest savings nation in the world, but the per capita savings as of June 30, 1940 were $196. So that there is yet a tremendous field for this business which has not been touched. Mr. Carpenter told me in Cleveland that he had made twenty-five interviews that week and in no instance did any man whom he interviewed mention defense bonds, so that we feel that there is still a great field for this business regardless of any so-called government competition.

Q. Then, in your opinion, Fidelity can be reorganized and rehabilitated under a proper plan of reorganization?

A. That is right.

Mr. Ray: That is all.

Cross-examination.

By Mr. Palmer:

Q. Mr. Reed, what was your official title for the work that you did with Fidelity?

A. My title was vice-president, which title was given me to increase my prestige with the field force and with the organizations which I contacted. I made a great many
[fol. 1893] speeches to Rotary Clubs, Kiwanis Clubs, bankers' associations and so on, and it gave our sales organization added impetus to advertise the fact that an officer of the company was to be present at a certain place at a certain time. I had no authority to sign checks. As a matter of fact, my vice-president's title was more honorary than——

Q. When did you first go with the company, Mr. Reed?

A. November 20, 1923.

Q. What position did you take with the company then?

A. I was a salesman—I was a representative in the Pittsburgh office. I soon became associate manager in the Pittsburgh office and was elected on the board and afterwards elected vice-president.

Q. When were you elected to the board of directors?

A. I believe in '25.

Q. That is the board of directors of Fidelity?

A. That is right.

Q. Your original employment was with the National Sales Company?

[fol. 1894] A. That is right.

Q. Not Fidelity?

A. That is right.

Q. And in 1936 what was your occupation with Fidelity?

A. Vice-president.

Q. In charge of sales?

A. No, sir. No, in charge of bank and public relations. Carroll D. Evans was vice-president in charge of sales.

Q. For how long a period of time did you work on commission with Fidelity—from when to when?

A. I would say approximately two years.

Q. When was that?

A. From '23 to '25.

Q. And after that time did you work entirely on salary?

A. Yes, sir.

Q. Did you ever receive any commissions at any time after that from either National Sales Company or Fidelity?

A. After 1925?

[fol. 1895] Q. Yes.

A. No, sir. Well, I may have sold two or three contracts on which I received a limited amount, probably not a hundred dollars. I purchased a number of contracts myself on which I did not take the commission.

Q. In 1936 there were seven officers in the sales end who were receiving more than $10,000 a year. Were you one of those?

A. No, sir.

Q. With reference to the note of the National Sales Agency——

Mr. Ray: I want to ask a question about those salaries. Where was that?

Mr. Palmer: I will find that, Mr. Ray. (A pause.) On page 105-106, beginning at the top of page 106, compensation paid by the association to employees other than officers and directors, reported for the year 1936 only. The sales representatives of the association up to September 7, 1934 were employees of the National Sales Agency, Incorporated. In 1936 seven employees of the association each re-

[fol. 1896] ceived more than $10,000 from the association. The combined total of the payments to such employees were $116,089; the two highest amounts paid were $25,777 and $22,741.

Mr. Ray: Where did you get the word "salary" which you used?

Mr. Palmer: If I used it I should have used "compensation."

Mr. Ray: I have no objection if you use "compensation".

The Court: I understood you said seven persons in the sales company.

Mr. Palmer: That is what I gather from this, Your Honor.

The Court: I don't gather that. That says seven employees of the association.

Mr. Palmer: But it spoke in the line before that of the sales representatives up to September 7th being employees of the National Sales Agency, and says this was compensation paid association employees other than officers, directors, reported in 1936, and I presumed they were talking about sales representatives.

Mr. Jaegerman: The sales company was not an associa-
[fol. 1897] tion but a company.

Mr. Palmer: But in 1934 the company took over the sales end of it.

The Court: As I say, it is possible to imply it from the language, but I believe you ought to be careful in quoting from that report to get what the report says, because otherwise it may be misleading to the Court in reading over the record.

Mr. Palmer: I am sorry if I did misquote it.

Q. Mr. Reed, were the seven employees who received more than $10,000 each in the year 1936 in the selling end of the association?

A. They were in the selling end of the association, and those figures do not mean anything, because they were all gross amounts paid to these men from which they had to pay their own travelling expenses and a great many other expenses in connection with their activities; and if you were to check their income tax records you would find their net was a great deal lower than that. There was a great deal of expense.

Q. They are still the amounts the company paid out to men in the selling end.

[fol. 1898] A. And we are only sorry that we couldn't pay them more, because they were on a straight commission basis, and the more business they did the more we paid them.

Q. And when the total commissions paid for the years 1927 to 1936 amounted to 18.9 cents per dollar, were you sorry that you couldn't pay more of the money out to each salesman from each dollar paid in by the investors?

A. Well, I don't know about the percentages, but the amount which we paid out—you must understand that our business was a highly competitive business, and we certainly couldn't—in order to compete with salesmen who are after positions with Investment Trusts and with the Investors' Syndicate and with the United Company of Kansas City and all of the life insurance companies, we had to pay a fee similar to—our setup was similar to those sales organizations of those companies.

The Court: Is that about the average that is paid to salesmen of all those companies in that same line of business?

[fol. 1899] A. Yes, Your Honor, just about the average. There may be some leeway one way or the other. Of course, in the insurance business they pay them considerably more than we did. We paid all our commissions in eight months, whereas insurance companies pay them over a period of nine or ten years.

Mr. Palmer:

Q. Do you mean to say, Mr. Reed, that any insurance company in the United States pays out probably 19% of its income over a ten-year period to its salesmen?

A. I don't know what percentage it pays over a ten year period, but I know that their commission rate eventually takes care of the entire initial payment of the insurance. That is the reason that an insurance *company* hasn't any cash surrender till after three years, and then it is very small, because for each $1,000 in liabilities an insurance company must pay $7.00 into the reserve at age thirty. All the rest is overhead and takes care of the supervisory cost, the manager, the collection agents and all the balance.

Q. Do you think any insurance company keeps as income [fol. 1900] twenty-five cents out of each dollar paid in today?

A. I can't answer that.

Q. Can you name me any insurance company that pays 19% of its income over a ten year period to its salesmen?

A. 19% of the income?

Q. Total income from premiums paid in.

A. I couldn't tell you on a percentage basis anything with reference to insurance payments. I know this, that practically the entire initial payment is used for overhead eventually, although it takes ten years to pay it out.

Q. Yes, but it doesn't take anything like 19% of the entire premiums paid in over ten years to do that.

A. I don't know what the percentages are.

Q. Now, with reference to this note of National Sales Company of which you were speaking, you stated that the money was taken from the general or stockholders' fund to pay off this note, didn't you?

A. That is right.

Q. Isn't it a fact that the note was transferred in 1936— [fol. 1901] this claim of the association against National Sales Agency, Incorporated, was split into two parts and transferred by the association to the Paull Company and the Marston Company, both wholly owned subsidiaries, and that the aggregate balance due December 31, 1936 was $858,-918.24, of which $731,636.39 was carried by Paull Company and $127,281.85 was carried by Marston Company; that these claims became part of the assets against which these subsidiaries issued collateral trust certificates to the association which had a face amount of $4,413,000 at December, 1936; that A. L. King, one of the major stockholders of the National Sales Agency, Incorporated, was vice-president and comptroller of the association December 31, 1936; that the only assets of National Sales Agency, Incorporated are the rights to commissions applicable to installments of certain outstanding certificates issued prior to September 7, 1934; that how much of the indebtedness can be ultimately paid off by the application of such commissions is conjectural; that during the years 1935 and 1936 the indebtedness was reduced from $1,048,402.81 to $858,918.24, a total re- [fol. 1902] duction of $189,000-odd dollars; that since the bulk of selling commissions are payable out of the early installments and sufficient time has elapsed to have cleared all payments on outstanding certificates not in arrears, it appears doubtful if this indebtedness will ever be substantially reduced? What have you to say about that?

Mr. Ray: What is inconsistent with what the wifness said?

Mr. Palmer: It was not paid out of the general fund.

Mr. Ray: Where did this say it was paid?

Mr. Palmer: Paid out of commissions on sales.

Mr. Ray: What is inconsistent?

Mr. Palmer: The inconsistency is that this witness has indicated that money already in the stockholders' or general fund was used to reduce this note when it wasn't the fact at all. The note was taken over and the commissions which later came in from sales already made by the National Sales Company were used to reduce the note instead of putting them in the general fund.

[fol. 1903] Mr. Ray: I don't remember anything the witness said about money already in the fund.

The Court: The witness said that originally this note amounted to more than eleven hundred thousand dollars, but it was reduced to $750,000 by payments from the general or stockholders' fund, but I don't remember his saying that it was money already there, although that may have been implied.

Mr. Palmer:

Q. And didn't you further say that if let alone the general or stockholders' fund would have continued until this note was paid off?

A. Yes, sir.

Q. Where were they going to get the money to do that?

A. From the earnings on operations.

Q. From the earnings on operations of what?

A. The Fidelity Investment Association.

Q. They didn't earn any money in the general fund in the last ten years, did they?

A. They were earning money in the general fund in '38.

Q. That is one year?

[fol. 1904] A. That is right. They earned considerable money in the general fund from security profits in many years, tremendous amounts of money. As you can see by the record, I think outside of one or two years their earnings were entirely satisfactory on the basis of relation to the common stock; and by increasing our volume $5,250,000 one month, which means $10,000,000 the second month and fifteen million the third month, and with the underwriting fees coming in, and with the idea that we can put on the books $6,000,000 without increasing our overhead in the home office, enabled us to make a profit per unit much

greater when we had a greater volume of business. Just as Henry Ford builds automobiles; if he built three or four it would cost a considerable sum of money, but by doing it the way he does it he was able to cut down the cost.

Q. Let's see if it wasn't sales talk like that that resulted in this. Immediately following what I read you before, on page 99,

"In its bill of complaint against Fidelity Investment Association, the Commission alleged that the management [fol. 1905] of the Association transferred certain questionable assets to Paull Company, Marston Corporation, and Marietta Company in order, among other things, 'to conceal the indebtedness of the insolvent and dormant National Sales Agency, Inc., to the General Fund and to the various Contract Funds'. In its answer, the Association denied that the subsidiaries named were organized to conceal the indebtedness as alleged. The final judgment of the District Court perpetually enjoined and restrained the Association, among other things, from 'creating or maintaining subsidiaries to conceal the nature or amount of indebtedness or investments, or employing any other device, scheme, or artifice to defraud.''

The Court: Mr. Palmer, I have said a good many times in the course of this hearing that I didn't want the questions to assume the character of that question and the questions you have been asking him. You are coupling up with a question to this witness extensive readings from that record, which the Court will read when the time comes, and for no other purpose that I can see than just to get them into the stenographer's record here, and all I can tell that that does [fol. 1906] is to increase the size of this record and the consequent expense. It certainly can't enlighten the Court for you to read that book and ask this witness if it is true or what he thinks about it. The record is in; the Court will read it; and I think that is enough.

Mr. Palmer: I am asking him the fact, Your Honor, if the answer he made just before in the nature of a sales talk as to what could happen to Fidelity, wasn't the very cause of such a decree having been entered in Detroit against it.

The Court: You might just as well say, "Wasn't it the cause of all this?" and then read that book to the Court, and I don't see any necessity of that.

Mr. Palmer: I wanted particularly as to this Sales Agency note, which the witness said could and would be reduced by the company, and gave a sales talk as to why it could be, to ask him if that wasn't the way the company got into this difficulty in Detroit.

Mr. Ray: I see no reason why Mr. Palmer should criticize the witness's testimony as being a sales talk.

[fol. 1907] The Court: I will sustain the objection to that question, and it is about time that we usually have an afternoon recess, so we will suspend and take a recess until 3:30.

(At 3:20 o'clock P. M., a recess was taken until 3:30 o'clock P. M.)

After Recess. 3:30 P. M.

Mr. Palmer:

Q. The next thing you said was wrong with the company was that from the general or stockholders' account an amount was put into the special income reserve. Is that correct?

A. That is right.

Q. Isn't it a fact that there has been evidence introduced here that if the special income reserve would pay the notes it owed the other funds it would be absolutely and wholly insolvent? By insolvent I mean it would have no assets.

Mr. Ray: I want to object to that question, Your Honor. How could this witness possibly be able to answer that question when the witnesses have been excluded from the court-room?

The Court: Sustained.

[fol. 1908] Mr. Palmer: This witness has been in the court room ever since he has been here, if Your Honor please.

The Court: It is not proper to ask him what evidence has been introduced in the case, if it is in.

Mr. Palmer: I was asking him if he didn't know that.

Read the question.

(The question was read.)

Mr. Palmer: The Court is correct.

Q. Mr. Reed, do you know that if the special income reserve would pay the notes it owes to the other funds that there would be nothing left in that reserve?

A. No, I don't know it.

Q. What was put in from the general account to the special income reserve?

A. You mean in amount?

Q. Yes.

A. I couldn't tell you the total amount. I know at one time it was as much as $200,000 in one year.

Q. Wasn't it put in from other accounts and a note given, [fol. 1909] instead of coming from the general account?

A. No, sir.

Q. Where did the notes come from that the special income reserve gave to the other fund?

A. Now you are asking me something that I am unable to answer, because you must understand that most of my time has been spent in the field, and that I did not have an insight into all the ramifications of the various reserves, beyond the general idea that the income reserve needed more funds, and from the earnings of securities in the general account we placed a certain proportion in that reserve. As to notes and the intricate bookkeeping I have no knowledge, because my time was spent in the field.

Q. All right, sir. And now you said one of the other troubles was that you had certain contracts that paid four and four and a half per cent improvement on the reserve which had been issued at earlier times when bonds yielded higher returns. Is that correct?

A. That is right. I assumed that rate.

Q. Beg pardon.

A. The rate was assumed at four and four and a half per [fol. 1910] cent. It was not the rate that we paid.

Q. You were familiar with the Series B income reserve policy were you not? Did you know that that contract upon maturity without the insurance feature yielded only 2.56%, and that it cashed in at the end of 126 months at a yield of 2.41%?

A. Yes, those figures were contained in the prospectus which we left with each contract owner who purchased a contract.

Q. Did you further know that with the insurance feature it yielded 1.55% at maturity and 1.34% at the end of 126 months?

A. Yes, sir.

Q. Would you produce for me the prospectus which was given to the prospect which contained those figures?

A. I haven't them.

Mr. Palmer: May I ask the debtor to produce such a one which advised the prospective purchaser of those yields? (A pause.) May I see one of the prospectuses we have? Perhaps that will answer our requirements. Mr. Schurr says it will take a little time to check that, but if we are [fol. 1911] unable to find that in any prospectus we have may we have that prospectus furnished, please?

The Court: Go ahead.

Mr. Palmer:

Q. Will you describe the prospectus, so the attorney for the debtor will know what type or sort to look for?

A. Well, it was a prospectus containing our financial statement, a record of the loading in the contract as to what the various amounts are allocated to, the basis of yield as outlined in your remarks and contained a slip, and the purchaser signed the slip, which became a part of our records indicating that he had received the prospectus.

Q. Can you tell us when that prospectus was issued, approximately?

A. When it was issued?

Q. Yes.

A. I would say it was issued about January, 1939.

Q. Then the fact that you had these contracts calling for an improvement of reserve at four and four and a half per cent was not one of your difficulties when the return that you were paying was 1.34 and 1.55 and these various other percentages? Isn't that true?

[fol. 1912] A. That is not true. The assumption of the reserve on a four and four and a half per cent basis means that we must earn all of the money over and above the loading on a four and four and a half per cent basis. The fact that we only returned to the contract owner these various yields hasn't anything to do with the fact that we assumed a four or four and a half per cent basis, anymore than your insurance is set aside on a three or three and a half per cent basis to you as an insurance holder over and above the amount deposited in the reserve per thousand may return you much less than 1%. As a matter of fact, I would like to get over to you the fact that I have made a study of thrift covering a great many years. I have talked to bankers' associations all over this country and to security commissioners' associations. A price appeal never made people

save money. If it did there wouldn't be any savings in the bank accounts today, and we know there are $25,750,000,000 in the savings banks in this country today, which is just about an all time peak. Back in 1915, when savings were 4% and 4½ and 5%, the total amount on deposit in sav- [fol. 1913] ings amounted to $7,700,000,000 so you see we never sold this business on price appeal any more than they ever sold insurance on price appeal.

Q. By price appeal you mean yield to the investor for the amount involved?

A. Correct.

Q. What was the primary selling feature, then?

A. The plan. The thing which made me buy one of these contracts after having worked in a bank twenty-two years during which time I was never able to save money despite the fact that savings department was located thirty feet from my desk—but by adopting this plan and maturing the size of the contract I was able to send our one son to Virginia Military Institute and Augusta Military Academmy, and I am sure if it had not been for the plan I would not have been able to do it.

Q. What do you mean by the plan?

A. The plan that calls for regular payments over a period of 126 months, when you receive a reminder each month, and when you know that if you stop paying there is a penalty to it, a plan of which the strongest feature is the fact [fol. 1914] that you can't get all of the money out for six or seven or eight years, is the kind of plan which makes people save money; and while thereare many flexible features in connection with the plan which we think takes care of every emergency, the fact that each month a *daily* reminder—the fact that fifty-eight bankers in the City of Pittsburgh carried this plan indicates that if they sent their money to Wheeling, West Virginia, instead of keeping it in their own saving accounts, it must be clear that they did it because of the plan, not because they do not trust their bank. The contract owners in the Union Trust Company of Pittsburgh, which has a capital of a million and a half and a surplus of eighty-seven and a half million certainly think their money in the bank is safe; the stock sells for $7,000 a share and it pays 206% annual dividends; but they like the plan, and senior officers in that bank have been carrying contracts with us for years, as well as with practically all the banks in Pittsburgh.

Q. If this plan was the main selling feature, why did one [fol. 1915] of your pro-pectuses have on it the capitol dome of West Virginia, citing part of the state laws of West Virginia as to how to secure these were, and put on a picture of a vault which stated it was a West Virginia vault where the securities would be kept in order that they would be safe?

A. My answer to that is that our sales promotion manager thought that was a fine thing to assist us in selling contracts. My own opinion is that it didn't sell any; that the contracts we sold out in Atcheson, Kansas, and up in LaCrosse, Wisconsin, were sold because they liked the plan. Many of them, I am quite sure, didn't know even where Wheeling, West Virginia, was located, but they liked the plan and the fact that the business was sold on the enthusiasm for the plan based upon most of us carrying it.

Q. Isn't it a fact that every salesman in Wisconsin carried as an integral part of his kit the Wisconsin deposit law, so that he could tell the prospect that that man was absolutely safe, because this money was backed up by the deposit of the State of Wisconsin, and that was given to him by the sales organization?

A. It may have been given to him by the sales supervisor [fol. 1916] of Wisconsin. I confess I have never seen that prospectus.

Q. Have you seen the salesman kits they were given?

A. I never have inspected any salesman's kits.

Q. So that your idea is that any rehabilitation which will incorporate a plan whereby the person will periodically save, and if they don't save the company will keep their money or take some of their money from them for failing to save, is a good idea?

A. Yes, sir. And so said by very great and prominent financiers, and even a president of the United States has said that the way to make people save money is to charge them something for doing so. As a matter of fact, today in many states Christmas Savings Funds are opened with a charge for operating them, whereas originally they were opened and paid 4% interest. Now they pay no interest but charge them. As a matter of fact, I have a friend in New York who gave everybody a fountain pen when they opened their savings account. He says now he would be glad to give them a pencil to match it if they came in and closed it.

Q. Does that mean that that man feels that the bank can't [fol. 1917] make money on deposits made with his bank?

A. I don't think there is any question of it.

Q. Then how do you expect a company to be formed now to compete with those banks to be able to make money as a bank can't?

A. Because a bank must set aside a certain reserve by law, if they are a member of the Federal Reserve system, as high now as 16½% of their net deposits, with the Chairman of the Federal Reserve Board advocating that it be increased. We had no problem of that kind. A bank had to keep a tremendous amount of cash on hand for each and every emergency. We have no problem of that kind. Practically all of our reserve—100% of the reserve—goes to work in our business. We can't be compared to a savings account in a bank any more than we can be compared to a defense bond, in which all of the overhead and all of the expense in connection with the defense bond comes from the taxpayers.

Q. They have a great advantage on you in that defense bond.

A. They have an advantage over every form if they sell [fols. 1918-1921] it. I had the pleasure of making the first speech to the employees of the Federal Reserve system on thrift and defense bonds. We are all in favor of people buying defense bonds, but the total amount bought in July of the Series A amounted to $92,000,000 which is less than seventy-five cents per capita.

* * * * * * *

[fol. 1922] Q. Your business was that of public speaker?

A. Yes, sir.

Q. And since 1923 you have more or less been in the business of advocating people investing their money in this investment certificate?

A. Not on the public platform.

Q. Sir?

A. Not on the public platform.

[fols. 1923-1933] Q. You mean not on the public platform all that time?

A. No, you asked me if I was in the business of being a public speaker, and then you asked me if I had advocated people buying this plan, and I tied the two to-

gether, and I want to emphasize that any public address I have made has never had anything to do with this plan.

Q. I thought you said you had appeared before Chambers of Commerce and securities and insurance commissioners' meetings and spoken.

A. But not on this plan, except at a convention of the National Association of Securities Commissioners at New Orleans, when I followed Mr. Landis, the Chairman of the Securities and Exchange Commission, and then I spoke at their request on the Fidelity plan. Never in any public place have I advocated that anybody adopt our plan.

* * * * * * *

[fol. 1934] C. E. Smith, recalled, testified as follows:

Direct examination.

By Mr. Ray:

Q. Mr. Smith, I have been advised that among the assets in the Southern District of West Virginia there are approximately a million dollars of those assets evidenced by certificates of stock issued to Fidelity Investment Association or Fidelity Assurance Association, on which certificates the assignments on the back have not been executed by Fidelity Assurance Association. Is that cor-
[fol. 1935] rect?

A. I don't think the amount of a million dollars is quite correct. That is based on market value. I had occasion to check that today, and the stocks on deposit with West Virginia have a market value of approximately $600,000. Of that amount some of the stock certificates are registered in Marston Corporation and Paull Company and to those are affixed, for the most part, blank stock powers which are executed. I believe if you did not consider those that the market value of the stocks registered in the name of Fidelity Investment Association would be about $500,000, as compared with $11,000,000 in round figures, or rather $9,000,000 in round figures on deposit in Charleston.

Q. But those that are issued to Fidelity Assurance Association are not endorsed on the back thereof?

A. No, they are not endorsed.

Mr. Ray: That is all.

(Witness stands aside.)

Mr. Ray: I have one exhibit to introduce by Mr. Gribben. May I call him a little out of order and get rid of that?

[fols. 1936-1947] The Court: All right.

Mr. Reinhardt: If Your Honor please, while we are waiting for Mr. Gribben, I will take the opportunity to offer in evidence five papers that Mr. Thomas has furnished me which are copies of papers that are in the record in the state receivership proceedings of West Virginia. We can mark them all as one exhibit and letter the individual papers.

The Court: That is a good way to do it.

Exhibit 70

The papers referred to were admitted in evidence, as Exhibit 70, and the individual papers letter a, b, c and d. The same are attached hereto as a part hereof.

WALTER J. GRIBBEN, recalled, testified as follows:

* * * * * * * * *

[fol. 1948] Mr. Palmer: Do you show in 1932 what I have just read?

A. The $5,000 that is shown in the directors' minutes was paid to Sanders, Childs, Bobb and Wescot in two checks, one of $3,850.58, and the other $2500, which also includes the $5,000 and other expenses.

Q. My question is, was Mr. John Marshall's name included in your report on that as it is in the minutes of the board of directors?

The Court: What difference does that make?

Mr. Palmer: The inaccuracy of it.

The Court: We are not investigating inaccuracies in the minute book.

Mr. Palmer: We don't want a report submitted here which is inaccurate.

Mr. Ray: Which is more accurate, the cancelled check or the minute book?

Mr. Palmer: I don't know. Which is?

Mr. Ray: I should say the cancelled check.

[fol. 1949] The Court: If objection is made I will sustain the objection to any other question along this line that is not directed to whether or not these expenses were abnormal.

Mr. Palmer: If Your Honor please, I want to object to the Court's ruling in connection with leaving in evidence in this record the fees of Koontz and Koontz insofar as they may or may not concern the suitability of Mr. Ross Thomas as a receiver, for this reason. Until there has been some evidence, or iota of evidence, by any witness produced by the debtor that the fees were either excessive as paid to that firm or that work was not done for the amounts rendered, there is nothing for the Court to consider in the way of suitability. In other words, if these fees were paid for work done and necessarily done at the debtor's request, that would bear no relationship of any kind as to the suitability of Mr. Thomas as a state court receiver, and until there has been more evidence produced or an indication that it will be produced, I move that that be the same as the other fees.

The Court: The Court's holding on that is this. Any [fol. 1950] matter that would tend to show the connection of the firm of Koontz and Koontz with the old Fidelity company, the extent of those connections, the duration and so forth, I feel ought to be considered by me in the matter of determining whether or not a receivership with one of the firm of Koontz and Koontz acting as receiver is a suitable means of taking care of the interests of all parties concerned. Now, I say that, beca-se, as I stated from the beginning, so long as the proceeding is in this court I have no intention of letting any person who has been connected with the affairs of the company heretofore and has any responsibility whatever for getting it into the shape that it got in have anything to do with the reorganization process, if that is proceeded with, and I must bear in mind that Chapter 10 of the reorganization statute is very specific in prohibiting any connection with the trustee of any person who is interested in the debtor corporation. Now, if Chapter 10 is so specific in that respect, it seems to me it evidences a policy on the part of the United States to keep receiverships and trusteeships in cases of this kind out of [fol. 1951] the hands of those who have formerly been connected with the company. To that extent the evidence will be considered in determining that question.

Mr. Palmer: May I suggest to the Court that there has as yet been no evidence produced by anyone that Mr. Koontz or any member of his firm had anything to do with any wrong management of this company; and for the Court

to keep the matter of the question of fees in the record on the possible question of any wrong management by Mr. Koontz or his firm, until such evidence has been produced, I think would be improper.

The Court: I recall one statement made by your client, or a client that you are speaking for, the State Auditor, to the effect that the attorneys' fees paid to Koontz and Koontz were outrageous. I don't know how else to interpret that.

Mr. Palmer: I think, if Your Honor please, if you will recall the question asked Mr. Sims was if there were a certain number of thousands dollars of attorneys' fees paid, what he thought of that. He was not asked, "Do [fol. 1952] you know what work the firm of Koontz and Koontz performed or what they were paid." The name was carefully kept from Mr. Sims as to whom those attorney fees had been paid.

The Court: He seemed to indicate he didn't care who got it, he thought it was outrageous.

Mr. Palmer: He seemed to think there was too much attorneys' fees charged in general.

The Court: Well, he used the word outrageous. The Court, in considering the matter, of course will give whatever weight the evidence appears to be entitled to, but I think it does have a bearing and ought to be left in.

Mr. Palmer: May I state to the Court that there is no prohibition in any state court of the debtor's attorneys acting as receivers for the debtor? In fact, it is a very common practice to appoint them as receivers for the debtor.

The Court: A practice that has been frowned on many times by the courts.

Mr. Palmer: In federal court proceedings, but never in state court proceedings that I recall; and for that reason [fol. 1953] we renew our motion.

The Court: I overrule the motion.

Mr. Palmer: I would like a specific exception to the Court's ruling in that regard.

* * * * * * *

[fol. 1954] F. J. McNULTY recalled, testified as follows:

Cross-examination.

By Mr. Jaegerman:

Q. Mr. McNulty, when you were here last as a witness you were requested by the various representatives of certain states to bring with you or to furnish the Court with copies of the various forms of monthly reports that were sent to states having deposits of Fidelity securities.

A. Yes.

Q. Have you brought those with you?

A. Yes, sir, I have. Now, in this regard, I didn't make complete copies of each month's reports, but I took what could be termed typical copies of the reports and letters which were sent out each month, and going back over a number of years to 1935——

Q. Take, for example, the State of Missouri. You have examined your files for the State of Missouri and have brought with you what you consider representative copies [fol. 1955] of all forms or deposit notices sent to the State of Missouri?

A. Yes, sir.

Q. Did you do the same thing for the State of Wisconsin?

A. Yes, sir.

Q. May I have that?

(Witness produces paper.)

Q. Did you do the same thing for the State of Illinois?

A. Yes, sir. (Producing paper.)

Q. Did you bring some other representative states?

A. I have forms here for the State of Iowa, Alabama, Kentucky and Tennessee.

Mr. Jaegerman: Would any state representative or any party care to examine these files?

Mr. Farmer: The Tennessee file.

Mr. Jaegerman: I am informed by Mr. Schurr, who represents the Securities Commission of the State of Missouri, that he is satisfied with this file that has been brought by Mr. McNulty, and I will offer it as an exhibit.

[fol. 1956] Mr. Schurr: I don't know whether those figures are correct, but that is the type of report that was forwarded.

Mr. Jaegerman: May this be admitted, Your Honor, as Exhibit 72?

The Court: All right.

Exhibit 72

The papers referred to were admitted in evidence, marked as above indicated, and are attached hereto as a part hereof.

Mr. Jaegerman: I understand the State of Illinois is satisfied that this is the type of statement furnished the State of Illinois, and I offer this as Exhibit 73.

Exhibit 73

The papers referred to were admitted in evidence, marked as above indicated, and are attached hereto as a part hereof.

Mr. Jaegerman: Mr. Lauritzen, representing the State of Iowa, says he has no objection to this file going into evidence. I offer it as Exhibit 74.

Mr. Lauritzen: May I say for the record that I have no [fol. 1957] information whatever as to those reports. I represent Iowa here at their request, but I have been furnished with no information upon this subject.

The Court: How about the one in relation to Wisconsin?

Mr. Lauritzen: I am just checking those now, Your Honor, with the records I have here.

Exhibit 74

The papers referred to relating to the State of Iowa were admitted in evidence, marked as above indicated, and the same are attached hereto as a part hereof.

Mr. Jaegerman: I offer as Exhibit 75 the forms for Alabama, and the forms for Kentucky as Exhibit 76, merely as being representative of whatever assistance they may be for the record.

Exhibits 75 and 76

The papers referred to were admitted in evidence, marked respectively as above indicated, and the same are attached hereto as a part hereof.

Mr. Jaegerman: I am informed by Mr. Farmer that he has no objection to this Tennessee file being admitted in [fol. 1958] evidence, and therefore offer it as Exhibit 77.

Exhibit 77

The papers referred to were admitted in evidence, marked as above indicated, and the same are attached hereto as a part hereof.

Mr. Jaegerman:

Q. Concerning the Wisconsin file, Mr. McNulty, does this contain a copy of every deposit form or notice sent to the State of Wisconsin from 1935 to date?

A. Yes, that was typical of the usual monthly report.

Q. It does not contain every monthly report, but contains representative months?

A. Yes, sir, I have reports like this in our files monthly.

Q. Were reports sent monthly to Wisconsin or were semi-annual reports sent to Wisconsin in the early years?

A. No, from back in 1935 a monthly report has been furnished, to my recollection and knowledge.

Mr. Jaegerman: I offer this Wisconsin file as Exhibit 78.

[fol. 1959] Exhibit 78

The papers referred to were admitted in evidence, marked as above indicated, and the same are attached hereto as a part hereof.

Q. Mr. McNulty, did you also furnish certain states with copies of the annual audit of Fidelity Investment Association?

A. Yes, sir.

Q. In past years?

A. Yes, sir.

Q. Do you have a schedule with you showing what states received all the annual reports?

A. Yes, sir, I have a schedule here going back through the year 1937, but I have letters or copies of transmittal here that go back in '35 and '36.

Q. The states that are represented in this schedule and on this file are Alabama, Connecticut, Delaware, Georgia, Illinois, Indiana, Kentucky, Missouri, Ohio, Virginia, West Virginia and Wisconsin. The schedule covers the annual

reports for the year ended December, 1937, December, 1938, October, 1939 and October, 1940. Your file also indicates [fol. 1960] that Missouri received a report as of the year ending December, 1936, and Wisconsin received reports of the years ending December, 1935, and December, 1936.

A. Yes, sir.

Mr. Jaegerman: I now offer this file and this schedule in evidence as Exhibit 79.

Exhibit 79

The papers referred to were in evidence, marked as above indicated, and the same are attached hereto as a part hereof.

Q. Have you brought with you the annual reports for the year ending December, 1937, December, 1938 and December, 1939?

A. Yes, sir. December 31, 1937——

Mr. Jaegerman: I offer the audit report of Fidelity Investment Association and subsidiaries of December 31, 1937, by Wilson and Cross, as Exhibit No. 80.

Mr. Lauritzen: Mr. Jaegerman, may I ask whether it is offered for the purpose of showing that is the report he referred to in his testimony showing what states got the various reports?

[fol. 1961] Mr. Jaegerman: That is right, and as copy of the report that was actually furnished these states.

Mr. Lauritzen: It is not offered to prove anything that is therein contained?

Mr. Jaegerman: It is not offered to prove the contents of the report, merely to show that the report was furnished and what is in the report was therefore notice to the various states. It is not offered as true or untrue.

Exhibit 80

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Mr. Jaegerman: I offer in evidence the Wilson and Meredith annual audit of Fidelity Investment Association and its subsidiaries as of December 31, 1938.

Exhibit 81

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Mr. Jaegerman: I offer in evidence as Exhibit 82 the an-
[fol. 1962] nual audit of Fidelity Investment Association and its subsidiaries as of October 31, 1939, as prepared by Haskins and Sells, Certified Public Accountants.

Exhibit 82

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Q. Mr. McNulty, was the fiscal year of the Fidelity Investment Association changed in 1939?

A. In the early part of 1939 it was changed to end October 31, of each year thereafter. That period covered a ten months period.

Cross-examination.

Mr. Huwe: Your Honor, the other day we were inquiring into the interpretation of the law with reference to whether the company had to deposit only contracts that were sold or contracts that were owned by people who resided in those states. I find under date of October 20, 1938, a letter, Exhibit 74, some reference to that particular question, and I would like to present that to Mr. McNulty and ask him to examine it and then state whether or not thereafter or [fol. 1963] prior thereto they followed any particular procedure in that respect.

A. Well, in all our reports, when a contract holder changes from one state to another, it was automatically changed on our records, and the state where the contract holder resided at the time the report was made would be included for that particular state.

Q. That was the practice of the company, then, under the law, regardless of your obligation under the law?

A. Well, it was assumed—some states specified that the liability shall cover contracts held by residents of that state, and others, I believe, say sold and issued and held.

Q. It would take an examination of all the state laws to determine that question correctly?

A. That is right, sir, and for uniformity we adopted a policy of reporting a liability on residents of the state at the time the reports were made.

Q. Would there be many states in which there was a considerable number of contract holders who did not buy their [fol. 1964] contracts originally in this state but who now own the contracts and reside in those states?

A. Well, if you take, say, two specific states, I would say no, but if you are talking about moving out of one state there might be fifteen or twenty move throughout the United States, but as to a change from one particular state to another particular state, I don't think the change would amount to very much.

Q. Then if all that was required under the law in some of those states was that the company only deposit securities that were in funds that were sold in those states, and the debtor decided to withdraw the securities over and above those that were sold only in those states, would there be much withdrawal or would it be a very small figure?

A. Well, I couldn't answer that. I would have to check that.

Q. You wouldn't be able to answer it?

A. It wouldn't be a substantial figure, but it would have to be checked.

Cross-examination.

By Mr. Palmer:

[fols. 1965-1966] Q. Do I understand the present list of contract holders submitted by the trustee, together with the assets, is based upon the states in which they live as shown by the books of the company?

A. I didn't prepare that statement. I couldn't answer that.

Q. Who did prepare that?

A. It was prepared under the direction of Mr. Smith.

Q. Mr. C. E. Smith?

A. No, Isaiah Smith.

Q. That has been the practice, however, to keep the names of the contract holders according to their residence, where they live?

A. Yes.

Q. Not where the contract was sold.

A. That is right.

. . . . . .

[fol. 1967] Q. Mr. McNulty, Exhibit 78, the folder of Wisconsin reports, apparently the earliest one you have here is July 31, 1935.

A. Yes.

Q. What does that mean as to whether there were any reports made earlier than that year?

A. Well, I didn't check back beyond '35, but certainly I think that there were at least interim reports filed.

Q. These reports in '35 appear to be semi-annual reports, do they not?

A. I just took two copies from each year's reports, and there was a report filed, I am sure, from July up through December of that year.

Q. That is for a half year period?

[fol. 1968] A. No, each month.

Q. I would like to have you be quite positive on that.

A. Well, I say that is my understanding of it.

Q. My records indicate that you commenced to make monthly reports only in 1939, and that previous to that time you had made reports either annually or semi-annually.

A. No, I am sure—(examining exhibit) I say that there were monthly reports filed during the year 1936. Here is two sample copies; one is as of September 30, 1936; one is as of January 31, 1936. That is no semi-annual period, and I am positive that there were monthly reports filed in between them.

Q. None of those reports purported to show the liability by funds, did they?

A. No.

Q. I think that is satisfactory, then, Mr. McNulty.

A. Yes, sir.

Q. Now, Mr. McNulty, I would like to have you identify these booklets here for me, if you can——

Mr. Jaegerman: May I interrupt?

[fol. 1969-1970] Mr. Lauritzen: Yes.

Mr. Jaegerman: You didn't mean that none of the monthly reports ever furnished Wisconsin showed the breakdown by months and by series? You mean 1935 and 1936?

Mr. Lauritzen: No, I did not. Let me try to clear that up.

Q. Do you know when it was that you ever informed Wisconsin of a series breakdown of liabilities?

A. You mean on our monthly reports?

Q. Yes.

A. I think the first monthly reports filed which showed the breakdown was June or July, 1940. That is my recollection of the file.

Q. And before that time you made no such segregation in your liability report?

A. Not to Wisconsin on the monthly reports, no.

Q. And did you on some annual report?

A. On our annual audit report the segregation of funds was shown.

* * * * * * *

[fol. 1971] Mr. Lauritzen: Mr. McNulty, showing you what has been marked for identification Exhibit 83, which appears to be a pamphlet in the nature of a prospectus relating to Series D contracts, can you identify that for us?

A. That is a descriptive booklet used by our sales organization.

Q. When was that booklet issued?

[fol. 1972] A. Well, 1939. I don't know the exact date.

Q. This Exhibit 83 was issued after the SEC injunction?

A. That is right, yes, sir.

Q. I now show you what has been marked Exhibit 84, apparently a similar pamphlet relating to Series B contracts. Was that issued at the same time and for the same purpose?

A. Yes.

Q. These two booklets, Exhibits 83 and 84, were in use for how long a time, Mr. McNulty?

A. Well, there were booklets issued at a later date than those, but a descriptive booklet was used up to December 31, 1940.

Q. I mean these particular gray ones, that is, Exhibits 83 and 84—you used that for just a short time during 1939? Am I right in that?

A. I would say yes, up until the figures of the next period were prepared, yes, sir.

Q. And do you know how long that would be?

A. No, I don't know how long that would be.

Exhibits 85, 86 and 87

[fol. 1973] Three booklets, at the request of Mr. Lauritzen, were marked for identification as above indicated.

The Court: How much more of this is there going to be, Mr. Lauritzen? We can't go on very much longer.

Mr. Lauritzen: I don't think it will be very long, Your Honor, but I will say we deem it of the highest importance.

Mr. Farmer: It is very important.

The Court: Is there any other examination of this witness after Mr. Lauritzen gets through?

Mr. Farmer: I think not.

Mr. Lauritzen:

Q. Mr. McNulty, let me show you some other pamphlets that have been marked Exhibits 85, 86 and 87, one being a descriptive booklet relating to Series B income reserve contracts, another being a descriptive booklet relating income reserve contract Series B, apparently a somewhat different color, and another one being a descriptive booklet relating to income reserve contract Series D. Can you identify those for me and tell me when they were issued and went into use?

A. As to the date they went in use, I couldn't tell you, [fol. 1974] but they were used sometime after, I would say, November or December, 1939.

Q. Now, comparing those last three booklets with these first two, we note that the last three contain considerably more information than the first two. Is that not correct?

A. I couldn't answer that without looking them over.

The Court: The books will show for themselves, if they are in.

Mr. Lauritzen: Yes, sir.

Q. Can you tell me, Mr. McNulty, whether, when these gray booklets were issued and went into use after the SEC injunction, there was any discussion had between the officers of Fidelity and the SEC relative to the propriety of this book being used under the terms of the injunction?

A. I couldn't answer that. I didn't have any discussion with them.

Q. Who prepared these gray booklets, Exhibits 83 and 84?

A. In what manner do you mean?

[fol. 1975] Q. Who got up the data in them?

A. Well, the financial figures were taken from the audit reports.

Q. By what person in your organization?

A. Well, I imagine the statistician at that time.

Q. Who was that?

A. He was Mr. Gass, that is my recollection of it now. I didn't.

Q. Looking at these next three booklets, can you tell me who got up the information in those and prepared and compiled those booklets?

A. The financial information was taken from the audit reports.

Q. But what person did it?

A. I can't say definitely. I don't know.

Q. Who would be the person that had charge of that particular matter?

A. Well, I think that these sheets in this report are taken from the same printing plate that was used by Haskins and Sells. I think it is nothing but a reproduction of the Haskins and Sells report. There wasn't any necessity of [fol. 1976] compiling the figures. Those figures are identical with Haskins and Sells'.

Q. But this other material in here, the narrative description of the contracts and the various sales talks, that is not from the Haskins and Sells report, is it?

A. No, I would say that was prepared by the sales promotion department.

Q. Who would that person be?

A. I think it was Mr. O'Brien.

Q. Do you know whether these three booklets, Exhibits 85, 86 and 87 were exhibited to officials of the Securities and Exchange Commission in order to determine whether they were proper for use in view of the consent decree that had been entered in Detroit?

A. I couldn't say definitely, no; I don't know.

Q. Who could tell me the facts in that regard?

A. The legal end would take care of that.

Q. Just who would that be at that time?

Mr. Ray: What difference would it make, Your Honor?

Mr. Farmer: It makes this difference, if the Court please. In those descriptive booklets that they issued [fols. 1977-1978] and that one of the witnesses said they

used to send out to their contract holders and made them sign receipts saying they got it before they took the contract, it told them there that the states had these deposits; and there are figures shown there by funds which would not necessarily control because of the fact that some of the states had these deposits. Now, we want to show that that was to go out to the public, the contract holders, and that the SEC concurred in those representations.

Mr. Reinhardt: Your Honor, I move that be stricken.

The Court: It doesn't make a bit of difference, as far as I can see, who compiled it. They say it was put out to purchasers——

Mr. Farmer: It amounts to this: they are telling the public one thing and if they are coming here today insisting on some other theory, the trust fund theory that Mr. Jaegerman evolved up there in Detroit for the first time, that is contrary to the representations to the public.

The Court: The particular question is, who prepared [fol. 1979] this?

Mr, Farmer: We want to get at this: we want to prove it was taken up with the SEC and all these booklets were shown to them and worked on.

The Court: That wouldn't have any bearing on it; who prepared it.

Mr. Farmer: That man would know about it. We are trying to find the man.

The Court: If you know, or think you know, it was taken up with the SEC, I think you would know who did it.

Mr. Farmer: That is what I am trying to find out.

The Court: Then you have no basis for saying it was taken up.

Mr. Farmer: I saw Mr. McNulty out in the hall the other day, and I think I quote Mr. McNulty, that he felt sure it was; that you all wouldn't have put it out without having assurance that it met with their approval.

The Court: Let him be asked that on the witness stand.

Mr. Farmer: That is what we are asking him.

[fol. 1980] The Court: There is no such question as that asked him yet.

Mr. Lauritzen:

Q. Mr. McNulty, after the trouble with the SEC and the injunction decree, one of the things the company had to be very careful about was to make a full disclosure to all

contract holders in order that the injunction decree would not be violated.

A. We were advised that that would be the proper procedure.

Q. You prepared these booklets to meet that situation, didn't you?

A. Yes.

The Court: Let me ask you this, Mr. McNulty. Do you know anything about the Securities and Exchange Commission having been shown this booklet that Mr. Lauritzen has in his hand and having signified its approval of it?

A. No, sir.

The Court: Then why ask him all these other questions? That is the point you were trying to get at.

Mr. Lauritzen: This Exhibit 86, for instance, relates to the balance sheet for Series B income reserve contract, and [fol. 1981] it contains a lot of footnotes to those balance sheets, and I would like to read you footnote No. 4. Up here in the balance sheet they show "Reserve Fund Deposited with State Authorities" as the last item on the asset side. Footnote 4 says, "The securities deposited with state authorities are subject to the requirements of the states with respect to all the contract funds of Fidelity Investment Association and are not necessarily held for the sole benefit of the holders of these particular contracts. In this connection reference is made to the foreword in this report." Now, according to your information, was the purpose of the company in issuing this booklet to give notice to any purchaser of a Series B contract that the securities shown on the asset side of the balance sheet in here might be subjected to liability for some other series in some one of the states under the laws of the states?

The Court: It doesn't make any difference what the purpose was, Mr. Lauritzen. You have shown that this booklet was sent out and that it was used in connection with the sale of those contracts. Now, so far as the Court [fols. 1982-1983] can see, that is the pertinent thing that you are driving at; and as far as the purpose of the company in putting it out, that has no bearing; the Court is not going to permit any questions on that at all. If a booklet containing these statements was furnished in connection with each sale, then that is sufficient for the pur-

poses that you are trying to put in evidence, so far as the Court can see. That is all we will have time to do with this witness tonight. If anybody else wants him, he will have to stay over.

Mr. Reinhardt: I want him, Your Honor.

Mr. Lauritzen: May I offer these in evidence, Your Honor? Is there any objection to them?

Mr. T. C. Townsend: This witness will have to remain.

The Court: Yes. Yes, these booklets may be received in evidence.

EXHIBITS 83-87, INCLUSIVE

The booklets referred to, having been heretofore marked for identification, were admitted in evidence, marked as above indicated. The same are attached hereto as a part hereof.

[fol. 1984] The Court: No.

Before we adjourn Court, the representatives of the Securities and Exchange Commission furnished certain certificates with reference to applications for exemption filed with the Commission, stating what action was taken and what the situation was with reference to them. I understand that Mr. Palmer wished to have that information go in evidence with reference to members of the Board of Directors of Fidelity, and if so, I would suggest that it be put in in some other way than by filing these certificates, [fol. 1985] because we want to lighten this record as much as possible. Can it be put in by stipulation?

Mr. Palmer: I think, Your Honor, we can probably put in, say one of them, and agree that the others are exactly the same except for the name; and, as I understand it, the Securities and Exchange Commission said that there was no action ever taken on those applications for exemptions filed.

The Court: That is what the certificate says.

Mr. Reinhardt: Whatever the certificate says is what the Commission will say.

The Court: All right. Suppose you take these, Mr. Palmer, and read into the record whatever is necessary.

Mr. Palmer: I have here, "United States of America, Securities and Exchange Commission, application for exemption filed with this Commission, February 3, 1941, by

John Marshall as director of Fidelity Assurance Association," and with the exception of the name each one of these is the same, for John Marshall, Jr., Harold Foster Pulfer, Howard Emmett Reed, Fred Smith Risley, Charles [fols. 1986-1987] Edward Smith, and Austin Andrew King; so far as being a director of Fidelity is concerned, although there might be a slight difference in wording as to other positions held by them; and we will submit the one of Mr. John Marshall as an example of all of the others with the agreement that the others are exactly the same except for the name and positions held.

Mr. Reinhardt: I have not examined any of these. I don't know whether they are exactly the same or not. If I find that there are any variations——

The Court: Change it tomorrow. That is right.

EXHIBIT 88

The paper referred to with respect to John Marshall was admitted in evidence, marked as above indicated, and is attached hereto as a part hereof.

Mr. Palmer: We are stipulating that the others are the same except for the name and character of connection.

Mr. Reinhardt: Subject to correction.

Mr. Palmer: Subject to correction.

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[fol. 1988] Mr. Lauritzen:

Q. I did talk to you, Mr. McNulty, after you left the stand yesterday with respect to the Wisconsin reports, and I believe the summary of your testimony was that it wasn't until July or August, 1940, that you informed the State of Wisconsin by monthly reports of the liabilities in Wisconsin by series.

A. Yes, it was in July, 1940 that I first——

Q. But you made the comment before that time that you thought Wisconsin had been so informed by virtue of the company's annual reports that you had from time to time sent out to Wisconsin.

A. Yes, sir.

Q. In that connection, it is a fact, isn't it, that those [fol. 1989] annual reports didn't show liabilities by states or by funds in states, but merely showed balance sheets of the various funds in all states?

A. No, I think that audit report for the the last—well, since 1936, I think would have some reference to the liability by states.

Q. It wouldn't have any reference to the liability by funds by states, would it?

A. I am not sure, but I don't think it was broken down in that manner.

Q. I would like for you to be quite positive on that, if you please, Mr. McNulty. I understood from what you told me off the stand it wasn't brokendown in that way.

A. Well, I said I didn't believe it was.

Q. Did you refer to such reports as the Haskins and Sells audits?

A. In this question here?

Q. Yes.

A. Am I referring to Haskins and Sells?

Q. Yes.

A. Yes, or to the audit report made by the firm be-
[fol. 1990] fore——

Q. (Interrupting) I don't suppose they are broken down by fund in the various states in any of those reports, are they—the liabilities?

A. I am not positive on that.

Q. Could I ask you to check that some time today, Mr. McNulty, when you get off the stand, and then let me know about that?

A. Yes, sir.

Mr. Lauritzen: Thank you.

Cross examination.

By Mr. Jaegerman:

Q. Mr. McNulty, these annual audit reports that have been introduced in evidence yesterday from 1937 to date do show segregation by series, do they not?

A. Yes, sir.

Q. And by funds within those series?

A. Yes, sir.

Mr. Jaegerman: That is all.

Cross-examination.

By Mr. Farmer:

Q. You mean by showing segregation by series that in
[fol. 1991] some of the reports in showing the liabilities in

the states you list special income so much, and special annuity so much, Series A, Series B and so forth, so much, and then show the total, but you don't mean that you broke down and said these assets over here were for special income and these for special annuity and these for Series A—you didn't do that in the Tennessee reports, did you?

A. We were talking about the audit reports.

Q. I thought you were talking about the reports to the state.

A. No, this is the audit report.

Q. Oh! you are talking about the audit report? Is that it?

A. Yes.

Q. And not the certificates that you sent to these state officials?

A. Well, the certificates were also broken down by fund?.

Q. That is what I said, in the liabilities, but not a corresponding breakdown by deposit of securities.

A. Well, in some states it was filed that way.

[fols. 1992-1998] Q. Yes, but you don't mean that was the general practice, and you have outlined the special instances where that was done?

A. Yes.

* * * * * * * *

[fols. 1999-2007] J. H. SCHELLHASE recalled, testified as follows:

* * * * * * * *

[fol. 2008] Cross-examination.

By Mr. Jaegerman:

Q. Before we proceed with our analysis of Series B, I would like to clear up one matter for the record, Mr. Schellhase. There was some testimony several days ago that in February, 1941, certain securities were withdrawn [fol. 2009] by the association from deposit in Charleston and several days later other securities were redeposited. Are you familiar with that?

A. That is correct.

Q. Are you familiar with the fact that there was about a $1,100,000 deficiency in the redeposit?

A. In the book value.

Q. Can you explain how that came about?

A. In rough figures the difference in book value was the agency note of $750,000 which the Central Trust Company

held in Cleveland, and also real estate notes on the several pieces of real estate we have had testimony on before, in the amount of about $423,000; so in all it would give you your $1,100,000, the difference between the book value of around $4,000,000 and that $2,900,000 that was put back into West Virginia.

Q. So that explains the apparent discrepancy?

A. Yes, sir.

The Court: And the note of $750,000 was worthless in the first place?

A. We considered it worthless.

[fol. 2010] Q. And the real estate was held as real estate on the books of the debtor, and since there were no securities representing it they couldn't be sent back?

A. No.

The Court: All right.

Mr. Jaegerman:

Q. What were the dates of that withdrawal and redeposit, if you know, Mr. Schellhase?

A. The withdrawal on February 11th and redeposit I think February 15th.

Q. Did the association recognize the worthlessness of these National Sales Agency, Inc., notes and set up a reserve against them?

A. Yes, they did.

Q. What was the amount of the reserve?

A. $750,000.

Q. What was the amount of the notes?

A. $750,000.

Q. About what date did the association set up this $750,000 reserve against the $750,000 National Sales Agency, Inc., notes?

A. I think it was December 31, 1940.

Q. We have been discussing the insurance feature of the [fol. 2011] Series B contract, Mr. Schellhase.

A. Yes, sir.

Q. And you have testified that fifty cents a month for the first sixty months was deducted as insurance cost and twenty-five cents a month for the second sixty months.

A. That is true.

Q. Please explain how those deductions were computed.

A. The amount of fifty cents and twenty-five cents was

computed so that it would make the bookkeeping simple in this way, that under Section 7, without insurance, additional credits were allowed on the contracts in the amount of fifty cents, so to make bookkeeping simple, whether a contract had insurance or didn't have insurance, we made the insurance deduction the same amount as the additional credits, although on actuarial tables set up by Fackler and Briby they showed the exact amount, or the estimated amount of the cost of the insurance. In other words, at the first payment on a contract, we would have to procure insurance for $676, and basing that on a dollar a thousand, [fol. 2012] we would have to pay 67.6 cents for that insurance at that time, although we only deduct fifty cents from the payments, as I say, to make the bookkeeping simpler and easy on our tabulating cards, so that the fifty cents a month deduction is not enough at the beginning of the contract and over a certain period of months to take care of that insurance—or the cost of that insurance.

Now, as I stated to the Court the other day—I would like to make myself clear—we paid the insurance company the full amount of the premium. Then, in turn, at the end of the year—or it was the practice of the insurance company, I think, during 1940, to give back to us some amount based upon the mortality figures that they had and a certain percentage that they took out for expenses and things—an amount of money back, so that as far as the deduction of fifty cents for insurance is concerned from the payments, it is not enough to take care of the insurance, but when the amounts that came back from the insurance company were taken into consideration it was then enough to pay for the cost of insurance, and I think we made [fol. 2013] a little profit, as I said the other day, on that.

Q. The Series B insurance feature was an additional source of profit to Fidelity Investment Association?

A. Small.

Q. Small or large, it was a source of profit?

A. Yes.

Q. It was a profit which was shared in by both the association and by the insurance company?

A. That is correct.

Q. Was this sharing agreement oral or written between the association and the insurance company?

A. I do not know. I can't tell you that.

Q. What was the insurance company?

A. Lincoln National Life Insurance Company of Fort Wayne, Indiana.

Q. Approximately how many Series B contracts are in effect today?

A. Approximately forty-nine thousand.

The Court: Let me ask this. Was the Series B the only contract sold after you started, or were there other con-
[fol. 2014] tracts also continued to be sold?

A. No, they stopped selling the Series A contract when the Series B contract came into existence.

Q. For how many years has the Series B contract been the only contract sold?

A. Your Honor, the Series B contract has not been the only contract sold. The Series D, which does not have insurance, and does not have an insurance feature, came into existence in 1935, and both the Series B and the Series D contracts were sold at the same time. I think the Series D was made mostly for Ohio.

Q. They are alike except for the insurance feature in the Series D?

A. No, not right exactly.

Mr. Jaegerman:

Q. There are some slight variations in the reserve improvement rate?

A. Yes, sir.

Q. Concerning the sale of Series A or Series B contracts in 1934, Series B was first offered on June 15th, 1934, according to your testimony yesterday. Is that right?

A. That is correct.

[fol. 2015] Q. For several months, due to the natural lag in having it qualified in the various states, were not the Series A contracts also issued and sold by the association in those states where B had not been immediately qualified?

A. I would say I think so. I am not sure about that, because I am not familiar with that.

Q. But that would only occur for a few months?

A. Yes, sir.

Q. Until Series B were qualified in all states?

A. That is correct.

Q. Where the association intended to do business?

A. Yes.

Q. What different categories of Series B contracts are there now?

A. There are six. The current contracts, on which contract holders have made payments within a year.

Q. What percentage of the presently existing Series B contracts are current contracts?

A. I would say about 42% at April 10, 1941.

Q. What others?

A. There are delinquent non-improving contracts; there [fol. 2016] are delinquent on a paid-up basis contracts; there are paid in full contracts; there are paid up contracts, and there are maturity and retirement contracts.

Q. What percentage of the Series B contracts were delinquent as of April 10, 1941?

A. About 47%.

Q. Pardon?

A. About 47% were delinquent non-improving contracts.

Q. So that the active and the delinquent non-improving comprised almost all of the Series B contracts?

A. Yes, sir.

The Court: What about the delinquent non-improving? Explain that a little further. What does that mean?

A. Those are contracts, Your Honor, that have less than twelve payments made on them. If a contract has less than twelve payments, there is no cash surrender liability. At the twelfth month the surrender value is $25.00; but before that time the contract has no surrender liability, although it does have a reserve liability from the ninth [fol. 2017] to the eleventh payment—created out of payments from the ninth to the eleventh payment. So we put those into a class by themselves, for the reason that since there is no cash surrender liability there is no need for improving those amounts of reserve. I might explain the delinquent on a paid up basis. After a contract has reached twelve months and has a cash surrender liability and a reserve liability, that is put into a separate category, for the reason that at the twelfth payment a paid up contract can be had, and those paid up contracts, there is no more money paid in on them, and the reserve on those contracts is improved, so that annually a larger amount of return is available to improvement.

Q. Those that have been paid on for longer than twelve months and then become delinquent are changed into paid up contracts for small amounts? Is that right?

A. It depends upon the amount of payments made on them.

Q. Well, I mean, for example, if you have a thousand or twelve hundred dollar contract which paid for a year, then during that year there are no cash surrender values, [fol. 2018] but as soon as the thirteenth payment is made it begins to have a cash surrender value? Is that correct?

A. At the end of the twelfth payment, Your Honor.

Q. As soon as the twelfth payment is made.

A. At the end of the twelfth payment.

Q. And it also, if it becomes delinquent at that time, has a value in providing a paid up contract.

A. That is correct.

Q. But that paid up contract would be a very small one?

A. Oh, yes.

Q. What would it be as the result of, say twelve payments? The first time that it had any value at all what would that value be on the basis of a $1200 contract?

A. I am not just certain of——

Mr. Jaegerman: Your testimony yesterday was $25.00.

A. That is the cash surrender value.

Q. It would be approximately the same, would it not? It would be future value of $25.00?

[fol. 2019] A. That is about correct.

Q. That all appears in the schedules in the contract, doesn't it?

A. Yes.

Q. And it is strictly a future value of that cash surrender value at the end of the future period, which in the Series D contract was 126 months, was it not?

A. That is correct.

The Court: That explains that feature. You testified a while ago that there would be during the current year about $800,000 of liabilities by reason of improvements if those improvements were made. You didn't figure anything for this 47% of Series B contracts that have no cash value, did you?

A. No, I was just giving an estimate, Your Honor I was figuring on reserves, not on cash values. You see, the cash values are only improved by the reserve being improved.

Q. But you didn't calculate that there would be any necessity for making any improvements to this 47% of Series B?

[fol. 2020] A. No.

The Court: All right.

Mr. Jaegerman: Mr. Schellhase, you have been talking about a contract being less than twelve months old or more than twelve months old. You don't mean from the date that contract was issued, do you, necessarily?

A. No, no. I meant twelve payments or less. It may be two or three or four years old. It has to be when it gets into the non-improving class more than a year old—I mean a year delinquent—so it could be two or three or four years delinquent at this time.

Q. So the forty-some odd per cent of contracts that you said were delinquent non-improving had less than twelve monthly payments made on the contracts.

A. That is correct.

Q. Although the contracts may have been issued as early as 1936?

A. That is correct.

Q. There are forty-odd per cent of contracts that you said were current or active. Some of those contracts may have less than twelve monthly payments made and some [fols. 2021-2033] more than twelve monthly payments made.

A. That is correct.

. . . . . .

[fol. 2034] The Court: Since they started selling the Series B, is what I am inquiring about. The purpose, of course, is to try to determine whether there is any prospect for continued business of that kind in the future. As I understand, the present requirements are that you shall not agree to improve this reserve at a higher rate than 3½%. Is that correct?

Mr. Jaegerman: Under the terms of the Investment Companies Act of 1940.

The Court: And now, from your experience with the company during the last stages, would it be possible to do that from return received from investments such as the company now has?

A. Improved at 3½?

[fol. 2035] Q. Three and one-half.

A. I doubt whether it would be possible to improve it at 3½, Your Honor. I would say something around between 2 and 3%.

Q. How do you arrive at that?

A. Of course, one reason is that we would have to conform to the—under the Investment Company Act we would have to conform to the laws of Washington, D. C., in regards to investments—the buying of investments.

Q. Mr. Young stated that that would be slightly more liberal than the portfolio the company now has. Is that your understanding?

A. Of course, I don't know about that, Your Honor.

Mr. Palmer: Your Honor, may I suggest this? I think what Mr. Schellhase has in mind—I may be mistaken—is that under the Investment Company Act of 1940 there has to be a sufficient reserve of securities deposited to improve at that rate, and it would require an additional deposit of securities in order to improve at this lower rate. Is that right, Mr. Schellhase?

[fol. 2036] Mr. Jaegerman: Before you ask that I think I ought to point out that the act only applies to new business, not to old business.

Mr. Farmer: We disagree with that construction, if the Court please.

Mr. Lauritzen: Doesn't it say here that "said company shall maintain at all times minimum sufficient reserves on all outstanding face amount certificates"? That means all, doesn't it?

Mr. Jaegerman: The interpretation has been that the old companies may remain in business without improving their reserves by that amount. That is by rule and regulation.

Mr. Farmer: Is that by rule and regulation of the Securities Commission?

Mr. Jaegerman: I don't know.

The Court: There is one feature about that the Court doesn't yet understand. The old Series B contracts provided for improvement in reserve at the rate of 4½%. It seems to the Court that that improvement at the rate of 4½% would require a higher yield on securities held by the company than would improvement at the rate of 3½%. [fols. 2037-2041] and that it would take a greater amount

of securities to provide the 4½% than it would the 3½% yield. Is that right or wrong?

Mr. Jaegerman: It would depend on what the securities are yielding. You need more securities at the same yield to give you 3½ than to give you 4½. If your securities are yielding 4½% you would need, say $100,000 at that rate, but you need less than $100,000 of securities at the same yield to give you 3½% of that amount.

Mr. Reinhardt: I think, if the Court please, that we could discuss this off the record.

The Court: Yes.

(There was a discussion off the record.)

The Court: Just put on the record that the Court now understands the fact to be that the lower the required rate in connection with the building of reserve, the larger the amount of securities that would be required to produce the required return at the end of the period. Is that right?

Mr. Reinhardt: Yes.

* * * * * * *

[fol. 2042] Q. Who got that difference between the cash surrender value and the active reserve that had been set up against that contract?

A. The Fidelity general fund during 1940.

Q. And that would be a part of the funds or the amounts that would be available in answer to His Honor's questions as to how the difference between the required improvement rate and the basic amount realized on investments was concerned?

A. That is right.

Q. So that the profit on cash surrenders was transferred to the general fund, and, in turn, used by the association to make up any deficiencies in earnings of the various funds?

A. Yes, it would be.

Mr. Palmer: May I ask one other question, for my enlightenment, Your Honor, at this time? If the profit were from the fund, why wasn't it left in the fund instead of being transferred back to this general or so-called stockholders' fund.

A. It was my instructions from the president, Mr. Risley, to transfer the gains on surrenders from the contract fund

[fol. 2043] to the general fund. I know nothing about what he based his opinion on or anything about it.

Mr. Jaegerman: Don't you know that was based upon legal opinion or legal work done by Koontz and Koontz for Mr. Risley?

A. I understood it was like that, but I have no proof of it.

Q. And that a friendly suit was brought in a state court in Kanawha County to be the basis for such a legal opinion by the firm of Koontz and Koontz?

A. That is what I heard.

Mr. Palmer: Then it was legally done, and your answer is that it was done by virtue of a decision of the Circuit Court of Kanawha County?

A. I have never seen that decision.

Q. That is the answer that you are giving to Mr. Jaegerman.

A. I said I heard that.

Mr. Palmer: Then it either ought to go into the record, Your Honor, as such, or be stricken. Either it is based upon a legal determination by a court or it is hearsay. The [fol. 2044] witness hasn't said anything about a friendly suit. Suits aren't friendly, and I think the Circuit Court of Kanawha County is above those remarks.

Mr. Jaegerman: Maybe he didn't have information about it.

Mr. Farmer: I object to the colloquy between counsel.

The Court: Go ahead.

Mr. Palmer: If Your Honor please, I move that the remarks of counsel as to it being a friendly suit, or any implication than any legal determination was other than honest and correct, in this county, be stricken from the record.

The Court: Well, the Court is aware that there are many such proceedings as that brought for the purpose of determining a legal point. I don't think there was any implication of impropriety in the counsel's question, so I overrule the objection.

Mr. Jaegerman:

Q. Mr. Schellhase, please explain how and why transfers were made from the Series B active fund to the Series B maturity and retirement fund.

[fol. 2045] A. The maturity and retirement fund is set up for the paying out of maturity values after the contract holder has completed his payments. At the time the contract holder has completed his payments the amount of reserve is taken from the active reserve fund in cash and transferred to the maturity and retirement reserve fund. From thence the commuted value or maturity value and optional settlements are paid; and that reserve is improved at the same rate of interest, 4½ compounded semi-annually.

Q. If that fund should earn more than 4½% compounded semi-annually, who would be entitled to the excess earnings?

A. The general fund of the association.

Q. If the active fund should earn more than 4½% compounded semi-annually, who would be entitled to the surplus earnings?

A. The excess earnings goes into the surplus of the fund, but the surplus of the fund is divided between 50% to the contract holders and 50% to the Fidelity general fund, based upon the valuation of securities at whichever is lower, cost or market.

[fol. 2046] Mr. Lauritzen: Mr. Jaegerman, excuse me. Don't your questions lose sight of the fact that you have got to maintain these state deposits up to their proper ratio at all times? Correct me if I am wrong. Or does that question assume that before anything went into the general fund, regardless of this arbitrary reserve improvement rate, that you would have to maintain your state deposits.

Mr. Jaegerman: I don't believe my questions have anything to do with the state deposit requirements or the maintenance of them.

The Court: It is true, however, as an observation on Mr. Lauritzen's question, is it not, that the cash values at all times were less than the reserve?

Mr. Jaegerman: Required reserve, yes, Your Honor.

The Court: And therefore, when the state deposits were maintained on a basis of covering all cash value liabilities, they would certainly be less than the reserve, and would not need to be as much as the reserve.

Mr. Jaegerman: That is right, but in a state like Wisconsin, where they might require 110%, it would be a mat-

[fols. 2047-2059] ter of mathematical calculation whether the reserve were or were not 110% of the cash surrender

value. Another complicating factor is that a state agency might use one method of calculating the market and the association might use another method. Furthermore, in many states the qualifying deposit should have come, in my opinion, from the association's general or stockholders' fund, and not from any contract fund.

Q. Do you have figures with you showing approximately what the present market value of Series B active fund securities is?

A. They are considerably more than book value. The balance sheets would show that.

* * * * * * *

[fol. 2060] Mr. Palmer: My question is based on this. I wanted to know from Mr. Young where he got the amount that was necessary to be deposited in each state. He said you prepared certain figures, at certain intervals, showing the liability of the company to those contract holders, both [fol. 2061] cash surrender, as you stated, and reserve liability, and sent it to him. Is that correct?

A. That is correct. That is every six months.

Q. Then there wasn't any other monthly one sent to him by you for that purpose?

A. Not by me, no.

Q. The next question I have is, from time to time in these states contracts were sold creating, after certain payments were made, new liabilities, both in cash surrender and reserve. Is that correct?

A. That is correct.

Q. How soon would you get those figures after a liability, both cash surrender and reserve liability, was created?

A. Is that the question?

Q. Yes, how soon would you get those figures?

A. Of course, if it was sold in between the six months report, the semi-annual report, it would come into the next semi-annual report.

Q. In other words, you would make your basis of report the six months period which had elapsed from the previous report? Is that correct?

[fol. 2062] A. That is the one that was sent to Mr. Young.

Q. So that during that interim Mr. Young had no figures as to the liability, either cash surrender or reserve, of the company to the contract holders? Is that correct?

A. Not unless he received copies of the monthly reports that were required by certain states. If he did that, then he received them oftener than six months.

Q. During that six months period, there were every day new liabilities created to the contract holders? Isn't that true?

A. That is correct.

Q. And as a practical matter, a six months report was all that you could practically submit? Isn't that correct?

A. That is correct.

Mr. Reinhardt: The testimony is to the contrary.

Mr. Palmer: The witness says yes.

Mr. Reinhardt: He has contradicted himself.

Mr. Palmer: I don't think it is the proper time to call attention to it.

Mr. Reinhardt: I do.

[fol. 2063] The Witness: When I am referring to possibility, I mean all states.

Mr. Palmer:

Q. So that there was bound to be a lag or lapse where there were liabilities in all of the states which had not been covered by deposits because of this six months period. Isn't that true?

A. Yes, except in those states where we reported monthly.

Q. Can you state any of those states by name?

A. If I do I may leave out one or two.

Q. Well, as best you can.

A. Alabama, Illinois, Iowa, Missouri and Wisconsin.

Q. Even with a thirty day report, with new liabilities coming in daily, there was bound to be a lag whereby the liabilities would be greater than the deposit because of the impracticability of submitting daily reports of that? Isn't that true.

A. I would say a small lag. There wouldn't be much. It would depend upon the cash surrenders too and the payments received in any one state.

Q. Of course, if securities went up in any particular fund, that would cover that fund as to the liabilities? Isn't that [fol. 2064] true?

A. If securities went up in any particular fund, it would be just that much more market value.

Q. And if securities went down, on the contrary, there would be that much greater liability not covered by deposit? Isn't that true?

A. Of course, it would depend on how much of a deposit you had up in that state.

Q. What I am trying to get at is this. If a state law requires a hundred per cent deposit for liabilities, it would be impossible, as a practical matter, to keep that up from day to day with regard both to a fluctuating securities market and new creation of liabilities by virtue of sales? Isn't that correct?

A. That is correct, unless you have—your market value was considerably higher than your liability.

Q. Unless you kept a sufficient amount of securities larger than your normal hundred per cent to take up any such lag or lapses—isn't that true?

A. Yes.

Q. And for all of the states you worked that out on a six months basis.

[fols. 2065-2072] A. That is correct.

Q. And West Virginia was included in that six months basis of reports.

A. That is right.

. . . . . .

[fol. 2073] Q. Now, Mr. Schellhase, you were telling Mr. Jaegerman that on cash surrendered policies, I believe it was speaking with reference to Series B, the profit made thereby was taken from that Series B fund and put into the general fund.

[fol. 2074] A. I was speaking about the difference between the reserve liability and the cash surrender liability.

Q. Yes, and that that was taken from the fund and put into the general fund. Is that correct?

A. During 1940.

Q. Have you said that you understood that the reason you did that was because there had been a decision made by the Circuit Court of Kanawha County. Is that correct?

A. That is correct.

Q. Now, with reference to Series B, you were required to improve the reserves at 4½%. Is that correct?

A. That is correct, compounded semi-annually.

Q. And I believe it has been shown to you that the Investment Companies Act of 1940 required improvement at not to exceed 3½%. Is that correct?

A. That is correct.

Q. So that if you were to continue with that same Series B contract, you would have had to put additional securities into that Series B fund in order to meet that requirement. Isn't that true?

[fol. 2075] The Court: Are you talking about the old contract or some new contract?

Mr. Palmer: No, the old contract, Your Honor.

The Court: I think that is a question for legal determination as to whether the Act applied to old contracts.

Mr. Palmer: I agree with the Court on that, but I am asking as a matter of fact, so we can get it for the Court if the Court should so determine.

The Court: All right, depending on whether the law so applies.

Mr. Palmer: Yes. My question is, if you would attempt to comply with that law with reference to the old Series B contracts, it would be necessary, would it not, to put up additional securities in that Series B fund or cut down the face amount of the contracts, one of the two.

A. Yes, if improvement was at 3½%, naturally the face value could not be paid on the 3½% basis as on the 4½% basis.

. . . . . .

[fols. 2076-2081] Q. Would 47% be a fair estimate of the number of contract holders who brought this particular type of investment who did not carry it on for even the first year?

A. I would say that is probably right.

[fol. 2082] Mr. Palmer:

Q. Mr. Schellhase, on the insurance feature of the Series B contracts, am I correct that Fidelity had a contract or agreement with Lincoln National Life Insurance Company of Fort Wayne, Indiana, furnishing that insurance feature?

A. That was my understanding.

Q. And it is further true, is it not, that that was a group life insurance policy except as to those past a certain age?

A. It was a group life insurance policy.

Q. And only those past a certain age had to take a physical examination before they could participate? Is that right?

A. That is correct, except in a few exceptions, except

where the questionnaire might have said something that the [fol. 2083] insurance company would like to have an examination.

Q. That person had to submit a written statement to the insurance company?

A. They submitted it to us and we forwarded it to the insurance company.

Q. What was the amount paid for each person by Fidelity to the insurance company per month for that insurance?

A. Well, it was in decreasing amounts. In other words, at the first payment we had to have $676.00 worth of insurance; at the next payment up until the end of the tenth payment we had to have $676.00. After that time it decreased in proportionate amounts to the amount we needed to pay the balance of the payments.

Q. What was it you said this morning about 67 cents?

A. Basing it on a dollar a thousand in round figures we would have to pay 67 cents for the $676.00 worth of insurance for the first payment.

Q. Why did you base it on a dollar a thousand?

A. That is what it runs us, about a dollar a thousand. [fol. 2084] The premiums varied a little one way or another.

Q. I understand that you paid on this 67 cents 50 cents a month at the beginning and 25 cents a month later.

A. That is the deduction for additional credits and the amount we also deducted or put into that column on our tabulating card, so that it was more or less for accounting purposes that we only made the amount 50 cents for deduction, because the additional credit of 50 cents was taken out and set aside in one reserve, and the 50 cents we took out, we considered that as insurance premiums.

Q. Let me ask you this. What did the contract with insurance cost as compared to a contract without insurance?

A. Well, the payments were the same on both contracts, a monthly payment of $7.50.

Q. Wherein did the one with insurance cost the contract holder more?

A. In the form, as I say, of additional credits. The contract holder received back these additional credits of 50 cents a month for the first 60 months and 25 cents a month [fol. 2085] for the last 60 months that we deducted from the contract.

Q. That is, the one who didn't have insurance received this credit. Is that correct?

A. That is correct.

Q. That credit did not represent, however, the true value that the other person paid for his insurance, did it?

A. That I am unable to state, for the reason that the insurance, after a given point would be less than 50 cents a payment.

Q. You told us that the company, that is, Fidelity, made a profit on this insurance by virtue of a payment back by the insurance company to Fidelity. Is that correct?

A. That is correct.

Q. What was this payment back of the insurance company to Fidelity? What was that?

A. Well, it was in the form of cash. As I explained to the Court before, it was figured upon the mortality of the contract holders that we had with insurance, how many of them died, and of course I am not familiar with the arrange-
[fol. 2086] ments or what all it said in the arrangements on that.

Q. Where would the contract be, or who would know about that contract between the two?

A. I think that was handled by Mr. Risley, is my recollection.

Q. Isn't it a matter of fact that it was a rebate given by the insurance company to Fidelity—a rebate of premiums paid?

Mr. Ray: Why do you say it was a rebate instead of a dividend on an insurance premium?

Mr. Palmer: I am asking the witness. I don't know what it was.

A. I don't know whether it was a rebate or not on insurance premiums.

Mr. Ray: I see no reason why that policy of insurance should not be produced, if it is pertinent.

Mr. Reinhardt: It is in, Mr. Ray.

Mr. Palmer: May I see it, please?

The Court: Do you refer to the agreement between Fidelity and the insurance company as to the sharing of profits?

[fol. 2087] Mr. Palmer: Yes, Your Honor.

Mr. Reinhardt: I understood Mr. Palmer referred to the insurance policy.

Mr. Palmer:

Q. Well, was there in the insurance policy any such agreement that you know of, Mr. Schellhase?

A. Not that I know of in the insurance policy that went to the contract holder.

Q. Then, in other words, this was a separate or private agreement unknown to the contract holder whereby Fidelity made a profit on this insurance? Is that correct?

A. Fidelity in its contract stated that it would carry insurance through a legal reserve life insurance company, and I think that the contract between Fidelity and the insurance company didn't have anything to do with the contract holder insofar——

Q. Your answer, then, to my question is that the contract holder did not know about this profit being made and had no way of knowing?

A. I don't know how they would know, unless they would receive a financial statement. They may have known from [fol. 2088] that.

Q. Was there, to your knowledge, any written agreement between Lincoln Life and Fidelity as to how much this dividend, rebate or kick-back, whatever it was, amounted to?

Mr. Ray: If Your Honor please, I am going to object to all this about profit, because whose money was being spent for this insurance premium? It wasn't the contract holders'; it was Fidelity's money. Fidelity agreed to furnish certain insurance to the contract holder and the contract holder paid a certain sum of money for it; and regardless of what Fidelity did with that money it was Fidelity's money; it was not the contract holders' money, and when he talks about profit, profit to whom?

Mr. Palmer: Your Honor, let's put it this way. We are trying to see if there can be a plan of reorganization, and we are trying to see if such a plan can work. If there was a profit made to Fidelity by some secret agreement which could not be made in a new company in which this agreement would have to be publicly announced, then we have to [fol. 2089] consider that as to whether or not that amount of money could be used in a new company.

Mr. Ray: I object to the language "secret agreement." There is not a bit of evidence about a secret agreement, and I call upon Mr. Palmer to point out any evidence about a secret agreement. The only evidence is that Fidelity and

the insurance company entered into a contract for this insurance.

The Court: Mr. Palmer's question, as I understand it, simply means that that contract or arrangement was not known to the purchaser of Fidelity's contract, which the witness says he thinks is correct, and I believe the matter, although not substantial, is pertinent for whatever it amounts to, and therefore I overrule the objection.

Mr. Palmer: Do you have my last question?

(The question was read.)

A. I don't know.

Q. Who would know among the officers or employees of Fidelity as to the terms of this agreement and whether it was written or oral?

A. As I say, I think Mr. Risley, had all conferences in [fol. 2090] connection with the Lincoln Life.

Q. Would any other employee or officer of Fidelity, to your knowledge, know of that agreement?

A. Not unless Mr. McNulty would know.

The Court: How about Mr. Isaiah Smith, who now is in charge of these records? Would he know about it?

A. He may know, Your Honor.

Mr. Palmer: What was the amount of profit——

Mr. Reinhardt: Would Koontz know about it?

Mr. Palmer: I don't know.

Q. What was the amount of profit made by Fidelity by virtue of this agreement?

A. Offhand I can't answer that. I don't have the figures before me.

Q. Who would have those figures?

A. Nobody has them here that I know of, unless you would find them in the audit reports that have already been submitted, by picking them out.

Q. Weren't they put on the books of the company?

A. They are.

Q. In what fund were they put on the books of the company?

[fols. 2091-2100] A. In the general fund.

* * * * * * * *

[fol. 2101] Q. That would mean that about five-twelfths of that amount would be free and the other seven-twelfths

would be frozen into segregated funds. Now then, in "Miscellaneous Income" you have got the figure $22,547.92. How much of that was this refund from the Lincoln National Life Insurance Company on these insurance contracts?

A. In the first place, the refund—I stated that we made $13,000 a little while ago on the insurance, but that wasn't the amount on the refund on the insurance.

Q. What was the amount of the refund?

A. I do not have that.

Q. Well, that is what we couldn't get.

A. Yes.

Mr. Palmer: I thought the witness gave you that as the amount of the refund.

A. I read that to you, Mr. Palmer, the amount that was in here, amount of insurance premiums collected from the contract holders and the amount of insurance paid net.

[fol. 2102] Q. And then on top of that there was this refund, which figure you have not given? Is that right?

A. No, the insurance refund is in the amount of insurance premiums here.

Mr. Farmer: Give me the page. Do you mind me looking at it with you?

(Mr. Farmer examines paper.)

Q. Do you find it in statement 20, page 2?

A. That is correct.

Q. That shows life insurance premiums $127,298.63.

A. That is correct.

Q. Is that a part of the payments made by contract holders that were thrown into this account for life insurance premiums?

A. No, that is expense—the net expense that we incurred. That is the amount we paid to the insurance company.

Q. Is that the amount you paid the insurance company and then got $13,000 back out of that?

A. No. Here is your income statement. It says there "income."

[fols. 2103-2106] Q. That is statement 20, page 1?

A. Yes. Life insurance premiums, the amount deducted is $139,698.50. The amount delinquent is $1,411.25, making a total of $141,000 that we collected from the payments.

Q. Set aside?

A. Set aside from the payments. Then we paid to the life insurance company net $127,298.63, which is the net figure. $13,000 is the difference between the amount we received from payments and the amount we paid to the insurance company after the refund.

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[fol. 2107] Q. Well, I want to ask you about the improvements of reserve. Was the amount of the improvements to the reserves on these various contracts for the year ending October 31, 1940, approximately $1,127,000?

A. I would say approximately it was. I didn't know the exact figure when I was up here this morning, but at noon I checked that figure.

Q. At the noon hour I asked you to go over those income statements shown in that audit report of Haskins and Sells, and had added up the improvements to the various funds and showed you the figures.

A. Yes.

Q. And that figure was $1,127,732.04, and you agreed with me that that appeared to be approximately correct.

A. That is right. That is what I said.

Q. On what basis did you figure that the improvement this year would be only $800,000? How did you arrive at that figure?

[fols. 2108-2112] A. I just estimated it in my head. I didn't know the true figure of November, 1940, at the time.

Q. Wouldn't the approximate figure be about $950,000?

A. Since we are not surrendering contracts I would say it probably would run around $900,000 to $950,000 on that basis.

Mr. Reinhardt: Is that for the entire year or——

A. For the entire year.

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[fol. 2113] Mr. Farmer:

Q. Mr. Schellhase, is this allegation of the SEC's bill true, that the company intended to and did fail to segregate and apply separately cash payments received from specific classes of contract holders, comingling said cash payments, has permitted its general fund and certain contract funds to overdraw cash in very large amounts from other contract funds, said overdrafts at times totalling in

excess of $5,000,000, with and without interest allowances, and in violation of contract and statutory requirements as to investment and deposit.

Mr. Ray: Your Honor, here we have the same type of question you instructed counsel not to propound yesterday, reading from this report and saying "Is it in there?"

[fol. 2114] The Court: As I understand that, Mr. Ray, this is a little different. This is something that Mr. Farmer has found in that report which he says has never been admitted nor denied by the company, and he is undertaking now to see whether the officer of the company admits that or denies it.

Mr. Ray: Why doesn't he get an officer of the company who is charged with the responsibility of answering that, and not a statistician?

The Court: That is another question. I am not so sure of that. It depends upon what this witness says about his knowledge of that fact. Now; Mr. Reinhardt objects on the ground that, not being denied, it perforce must have been admitted; but I feel that that is not necessarily so.

Mr. Jaegerman: Your Honor, my memory is that most of those facts were specifically admitted in the answer.

The Court: I don't want to go to too much length on these matters.

Mr. Farmer: I examined it to see, Mr. Jaegerman, before [fol. 2115] I asked the question. I didn't want to take up time.

The Court: But if it will be reasonably brief—what is the answer? I will overrule the objection.

A. The contract payments as they were received by the association were taken into each contract fund and the amounts recorded on their various fund bank accounts, although in the bank there was but one fund—bank account—for the income, the annuity, the Series A and the general fund. When maturities and cash surrenders were paid from that fund, it was charged on the books of the association to the particular fund whose contract was maturing or being cash surrendered.

Mr. Farmer:

Q. And the dates of the setting up of those funds are given in your answer to my questions just previously

asked, that is, those separate funds for the different series.

A. That is correct.

Q. Is it true that the company made transfers during the years 1937 and 1938 from special annuity contract reserve fund unmatured contracts of amounts aggregating [fol. 2116] three hundred and ninety-eight thousand—If the Court please, I am going to save time; I am not going to ask that. This is in this descriptive booklet that they sent out to contract holders. I believe that is proven and it is taking up time.

The Witness: I might add one thing to my answer right above there, that the bank accounts of the income, the annuity, M and R, the A M and R were carried to the one bank account, the same as the one bank account was in the bank.

Mr. Farmer: Let me ask you this——

Mr. Ray: Your Honor, may I make a motion with respect to this line of investigation? I move that it all be stricken out because on page 252 of this document is a paragraph of the answer of Fidelity in which there is a denial of the paragraph of the bill which Mr. Farmer has been quoting from.

Mr. Farmer: I didn't see that, but it is very well that I asked the question and got the facts about it, then.

The Court: I will overrule the motion.

Mr. Farmer: Well, I have just one more question, then, [fol. 2117] Mr. Schellhase. Assuming that during this year in which you have made up the estimate for the Court——

A. Let me say something about that estimate, Mr. Farmer. That estimate was made by me—of course, it was done roughly here in Charleston, and there may be a lot of things in here like this interest on delinquent payments that I have not given any effect to in my estimate down here; so I want to say that this is an estimated figure, and there may be a few changes in these, as you tried to bring out.

Q. I realize that, and really I was just trying to improve on it a little bit, to see if we can't get a little closer to the facts about it. If, during this year, the invested assets will be about 15% under the invested assets from which the income from investments was realized for the fiscal

year ending October 31, 1940, you would have to reduce your estimate of income from investments by taking off of the figure $924,394.00 15% of that amount, wouldn't you?

A. It all depends upon what assets were reduced. If you were reducing some of the assets that wasn't paying interest or something, then it would not be.

[fol. 2118] Q. Can you tell us any other basis than just making a flat reduction of 15%? Have you analyzed the decrease in assets to see whether it should be on any other basis?

A. No, I have not.

Q. Then, since we are giving the estimate, we will just have to use that basis, I reckon, of a 15% reduction.

The Court: He says that depends on whether the 15% that you take off has been something that is producing income. I think that is clear, isn't it?

Mr. Farmer: Of course, we just have to speculate on that, then, whether it was or wasn't, and what percentage it was. I am just trying to test the accuracies of his figures.

The Court: I see.

Mr. Farmer: If he can give us any more accurate figure, I would like for him to go out and get it.

Mr. Reinhardt: It wouldn't be more than 15%, would it, Mr. Schellhase?

A. No.

Q. It might be less?

[fol. 2119] A. Yes.

Mr. Farmer:

Q. Let's assume this 15%. 15% of $924,000 is about $135,000, so if we take off $135,000 and if we take $13,000 out of your miscellaneous income, and if we take off about $30,000—let's not do that first; we might not be right in that. Let's take off the $135,000 and the $13,000. That would take $148,000 off, wouldn't it?

A. Yes.

Q. And if we take $148,000 off of your figure of $1,061,000 that brings us down to how much?

A. I can't figure it.

The Court: $913,000.

Mr. Farmer: $913,000, and if the improvements on reserve is about $950,000, how much does that leave for taxes

on the home office building, for employees and maintenance of the building? How much would that leave us to pay this interest?

A. It would leave nothing if your figures are correct.

Q. Well, can you help us out any on it?

A. Not right now.

[fol. 2120] Mr. Reinhardt: I think I can help, Mr. Farmer.

Mr. Farmer: I will be glad for you to help me.

Mr. Reinhardt:

Q. Mr. Schellhase, you gave as I recall a figure of $950,000 for the imp ovement for the year 1941. Is that correct?

A. Approximately $925,000 to $950,000.

Q. The improvement stopped when in 1941?

A. April 10th.

Q. So that the actual improvement that would be required for 1941 would be something less than 5/12ths of $950,000? Is that right?

A. Oh, yes.

Mr. Palmer: May I interrupt? I thought Mr. Schellhase, in answer to Your Honor's question this morning, said the reserve would have to be improved throughout the entire year.

The Court: I thought that too.

The Witness: No, Your Honor, I said this morning that the improvement was stopped as of April 10th, when the receivers came in, and I thought your question was if it was continued to be made—if it was allowed to.

[fol. 2121] The Court: You said it was stopped on your books, but, as a matter of fact, when you keep this money in the custody of the company, it either doesn't make any return whatever or else you have to credit it with the improvement? Isn't that right?

A. It depends on whether, Your Honor, the courts themselves decide to put that improvement on the contracts or allow it to be put on the reserve or added to the equity in each contract.

Q. I understand.

A. You were under the impression or thinking that you may allow that?

Q. That is the basis of the question I asked you.

A. But as it stands on the books now we have only improved it up to April 10th, and that would only be 5/12ths.

Mr. Palmer: Then I would have to object to Mr. Reinhardt's question; it wouldn't be applicable.

The Court: It would be applicable in the event the Court did not improve the fund. Go ahead.

Mr. Reinhardt:

Q. Can you tell us what 5/12ths of $950,000 is, Mr. Schellbase?

[fol. 2122] The Court: About $60,000.

The Witness: About 40,000.

Mr. Reinhardt: 400,000.

The Witness: 400,000.

Mr. Reinhardt: What would that leave for the payment of taxes, salaries and other expenses?

A. I would think about $524,000—something like that. If you got it down to that figure.

Mr. Reinhardt: That is all.

The Court: All right, Mr. Schellhase. You may step aside.

(Witness stands aside.)

The Court: I would like to be furnished with the newspaper clippings that have been referred to containing a purported letter of Mr. John Marshall to Mr. Herschel C. Ogden.

(Exhibit F for identification was handed to the Court.)

The Court: The Court now has in his possession the original letter to Mr. John Marshall written by Robert E. Healy, one of the Commissioners of the Securities and Exchange Commission on May 9, 1941. I will read the [fol. 2123] part of that letter that refers to the matter in controversy raised by Mr. Palmer. I quote from the letter:

"Mr. Jaegerman and other members of the Commission's staff have been constantly in touch with representatives of Fidelity, including Mr. Koontz. A few weeks ago a proposed plan of voluntary reorganization was submitted to the Commission informally by Mr. Koontz, who requested an informal expression of the Commission's views. The plan was carefully considered by the Commission, and upon such consideration the Commission indicated that

the plan was of such a character that it was very doubtful whether the Commission would be able to render a favorable report thereon under the Investment Companies Act of 1940. The Commission further indicated that it would be unable to render a favorable report on any plan which did not comply substantially with the standards of Chapter 10 of the Bankruptcy Act in relation with corporate reorganization, and further that in its judgment it was very doubtful that a plan of reorganization could practicably be effected without resort to the reorganization procedure. [fol. 2124] of Chapter 10."

I would like for Mr. Palmer to take the newspaper item and point out to the Court the conflict he said existed there between Mr. Marshall's letter and the letter from the Commission on which it is based.

Mr. Palmer: All right, Your Honor:

"I also reported to the meeting the attitude of the Securities and Exchange Commission as outlined in the communication of one of the Commissioners addressed to me, in which he stated that the Commission would not approve of reorganization for Fidelity unless it was effected by the reorganization procedure of a federal court."

That letter states definitely that the attitude of the Commission was such that there was only, as Mr. Marshall in his letter said, one thing left to do, to go into a federal court. The letter which the Court has read expresses the doubtfulness of the Commission as to whether such a procedure could be had other than in a federal court, but does not say definitely, as does this letter, that it can only be [fol. 2125] done in a federal court. I think that distinction is very vital.

The Court: Is that the only thing you had to go on in all this talk about the letter?

Mr. Palmer: Yes, sir, Your Honor, and I think this distinction is very vital in view of the fact that Mr. Marshall said he reported to the meeting in Pittsburgh that this seemed to leave no other alternative, and by unanimous action of the board an officer of Fidelity was then authorized to file suit in federal court; and I think this second statement in the letter I am reading from is not warranted by the statement which the Court has read as being the Commission's letter.

The Court: I am frank to say that I think the distinction is highly technical, and does not excuse the counsel for taking up so much space in the record and for his words in impugning Mr. Marshall's attitude and conduct in writing the letter. It seems to me that the letter of Mr. Marshall to Mr. Ogden substantially reflects what is said in the letter from Commissioner Healy to Mr. Marshall. You [fols. 2126-2148] may now return the letter to Mr. Marshall.

* * * * * * *

Hubert F. Young, recalled, testified as follows:

* * * * * * *

[fol. 2149] Q. Mr. Young, when you received from Mr. Schellhase the figures which indicated the liability in each state as to both cash surrender value and reserve value, upon which of those figures did you make your deposit with the state?

A. Mr. Jaegerman asked me the same question. The cash values.

Q. The reserve liability was not a then due liability? Is that correct?

A. It was not a liability.

[fols. 2150-2151] Q. Beg pardon?

A. It was not a liability.

Q. What was it?

A. The cash surrender was a liability, but the reserve was built—the reserve, of course, is provided they carry the contract through to maturity. The minute they do, of course, the cash surrender and the reserve liability are one and the same.

Q. And then you increased the amount that was necessary——

A. It would automatically.

* * * * * * *

[fol. 2152] The Court: Any more questions of Mr. Young?

Mr. Palmer: I don't think so, Your Honor, I think this gives us all the information we need without reading it [fol. 2153-2159] to Mr. Young and just retranslating it.

There is one other thing, I do not believe it was brought out by Mr. Young before that one of the requirements of the Investment Companies Act was a net capital of $50,000,

and Fidelity having no capital, but being minus a million and a half, it couldn't go ahead under that Act.

A. That is the chief reason we couldn't qualify.

Q. Unless it got new capital?

A. Unless it got new capital, but under present conditions that was the chief stumbling block.

The Court: How much capital?

A. $50,000 in an old company. A new company requires $200,000.

Mr. Jaegerman:

Q. If the contract liabilities of Fidelity were reduced so it had $50,000 for capital, I suppose that would also comply, would it?

A. It would comply, yes.

* * * * * * *

[fol. 2160] Q. Isn't this true, that in order to realize this 3½ per cent which you said it would be possible for you to do, that you would have to invest largely outside of U. S. bonds and state, county and municipal bonds and mortgages on real estate, and have to get into these semi-speculative [fol. 2161] or speculative corporate bonds and stocks?

A. Certainly you couldn't put a very large proportion in the highest grade bonds and earn 3½ per cent, but it would not be necessary to do that.

Q. And you would have to invest largely—chiefly—outside of the class of securities that insurance companies are permitted to invest their funds in under the laws of the State of New York and the twenty-five other states in the Union that follow the New York standards?

A. No, I would not agree to that.

Q. You would not agree to that?

A. No. You would have to invest more, but not the majority by any means.

Q. Insurance companies are not, under present conditions, realizing 3½ per cent average——

A. They are getting about 3.06—I mean the New York insurance companies are.

Q. So you have *to* got to improve on their earnings?

A. Yes.

Q. Are you familiar with the spread or difference between the average yield on the corporate bonds rated Triple A in

[fol. 2162] Moody's and U. S. Government securities—bonds?

A. No, I am not.

Q. I suppose you would agree with me—I want to base a question on it—that according to the report of the Temporary National Economic Committee that I have in my hand, pages 44 and 45, in 1939 that spread or difference between the percentage yield on U. S. Government bonds and Moody's Triple A corporate bonds was .49 per cent, and since it states that that yield on U. S. bonds was 2.36 per cent, that would mean that it would not be possible in investing in U. S. Government securities or Moody's bonds to get more than 2.85 per cent on those investments.

A. No, it would not, but I don't see why you would try to invest in Governments and Triple A bonds.

Q. That is the point. You would have to get outside of those safe and sound securities—have to leave that field entirely.

A. There are safe and sound securities that are rated Double B. They don't have to be Triple A to be safe and sound.

[fol. 2163] Q. You think this thing could be set up as you have outlined and that a salesman could go out in the field and sell it to investors?

A. I have so stated.

Q. Of course, you don't think, Mr. Young, that the investors could be induced to put their money in this company, reorganized, if it were explained to them that they could invest their money in government securities yielding 2.36 per cent or something like that?

A. I think the average one knows that. Anybody you go to see knows that from the publicity the defense bonds have had. May I say this——

Q. They know that, but they don't know that the yield by the company on the installments paid to maturity is only about 2½ per cent?

A. They know this if they can read. They know if they are paying a thousand dollars and getting $1,050 they are not getting any big rate of interest. They certainly know that.

The Court: Mr. Farmer, the same thing you are asking about has been gone over carefully and in detail by Mr. Palmer, and I don't believe you ought to encumber the rec-

[fol. 2164] ord by repeating his questions and drawing his inferences.

Mr. Farmer: All right.

Q. Now, you talked about a plan that you had here, and as I caught it your plan contemplated cutting down these old contracts, these special annuity and special income contract holders.

A. I didn't say I had a plan. I said that was one of the possibilities of working into a plan.

Q. You said first it might be made an insurance company.

A. I said that is possible.

Q. Do you know any insurance company that would undertake to issue policies to these contract holders, who have not been selected on any basis of risk, either age or sex or physical condition?

A. I didn't say I would give them an insurance policy. We would give them an insurance annuity.

Q. And cut down on the existing reserves that they have now?

A. Possibly. Those are details.

Q. You would have to do that?

[fol. 2165] A. Would you? Well, you answer that.

Q. You said you were going to cut them down about 20 per cent, didn't you?

A. I didn't say I was going to cut them down at all. I said that was one possibility.

Q. Didn't you say by cutting them down to about 80 per cent it might be done?

A. I possibly did, 80 or 70 or whatever it works out.

Q. If you will assume with me that there are some twenty million dollars of assets in this company, or better than that, which could be distributed among contract holders on the basis of their cash surrender values at the present time—cash liabilities at the present time—of about twenty-three million dollars, they could get that amount out of liquidation if you just sold them out and distributed the money, couldn't they?

A. I doubt it, after years of liquidation expense and the expense of litigation I don't think they would get anything like twenty million dollars.

Q. That would depend on court expense?

[fol. 2166] A. Yes, and you don't know what kind of market you are going to have by the time you liquidate. It

would take quite a while, in my opinion, to liquidate. It might drive the market down to the bottom when you start to liquidate, and instead of getting 70 per cent you might get 50.

Q. Those are conditions that you think might reduce the amount?

A. Easily.

Q. But what you are proposing to do is to cut down these old contract holders whose contracts at maturity would have to be much lower than 80 per cent wouldn't it?

A. Sure it would.

Q. And then invest the funds of this company in semi-speculative and speculative securities?

A. Well, if they didn't they would probably lose their money some other way in my opinion.

Q. Did you ever hear of Mr. Ponzi?

A. Yes, I have heard of him.

Q. He had his plan, didn't he?

A. Do you think that is comparable to ours?

[fol. 2167] The Court: Mr. Farmer, there is no use going into those matters that have nothing to do with this case. The Court doesn't like that.

Cross-examination.

By Mr. Huwe:

Q. Mr. Young, where the life insurance company makes a profit on its mortality rate, does Fidelity make a profit on the $700,000 between its reserve liability and its cash liability?

A. Yes, they have taken quite a profit there.

Mr. Huwe: Thank you.

The Court: Now, is there anything further with Mr. Young?

Mr. T. C. Townsend: Your Honor, I would like to ask Mr. Young some questions.

Cross-examination.

By T. C. Mr. Townsend:

Q. I believe you said yesterday when you were on the witness stand that it is your opinion, and gave reasons for

your opinion, that Fidelity could be reorganized under Chapter 10 of the Bankruptcy Act, did you not?

[fol. 2168] A. I did.

Q. Since you made that statement on yesterday have you received any information from any source that would strengthen that belief that you expressed that Fidelity could be reorganized?

A. I have, sir.

Q. What was it that you received that had a bearing upon that question?

A. I have been negotiating with a group of men in New York for some time. I first began negotiating with them with the idea of getting them to put additional capital in Fidelity, which, like a good many others, they couldn't see, naturally, and they were interested at that time of the purchase of Fidel; and since Fidel has ceased selling, in my opinion, it should be sold. At that time I wasn't sure it should be. It is profitable; we have a good sales organization; but times are entirely different. So for the last few weeks I have been negotiating with the same crowd to see if they would be interested in purchasing Fidel. I have done quite a bit of work. It is not a very easy thing to show [fol.2169] why anyone should buy it. And I have got a commitment from this group of men, very able men and very wealthy men—the list Mr. Dickinson has; I do not have the list with me—but they are men of unquestionable reputation and standing—and as an attraction to buying Fidel I intimated to them that if they were willing to put in a half million dollars and could work out a plan it might be possible to organize in some way Fidelity and throw the two together. I got a wire from them today. Would you like for me to read it?

Q. I wish you would produce the wire that you received.

(Witness produces paper.)

Mr. T. C. Townsend: Your Honor, that is not a very long telegram. I suggest that he be permitted to read it into the record.

The Court: All right. Go ahead.

Mr. Reinhardt: Your Honor, can't he read it, and the stenographer won't have to put it down in the record if it is going to be physically introduced.

The Court: Read it and let it be filed.

(The witness read the paper which is hereafter marked [fol. 2170] as Exhibit 90.)

The Witness: That is a group of men formed for just such purposes as this. It is a group formed for going into activities outside of their regular activities, some twelve or fifteen of them.

Mr. T. C. Townsend: I will offer it as an exhibit.

Exhibit 90

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Q. Mr. Young, have you made any calculations to determine, if that offer was accepted by the trustee, the amount that would be received for the stock of Fidel?

A. I would say it would be between one hundred and one hundred and twenty-five thousand dollars.

Q. And what was the amount of the stock of Fidel now?

A. Fidel put in originally $125,000. They have taken out profits, management fees, I will put it, some one hundred and twenty-five or thirty thousand; and the account is liquidating very rapidly. They liquidated 20 per cent [fols. 2171-2178] in the last sixty days, which means, of course, the income that—every day we are getting surrenders it will become less and less.

Q. Is it the fact that it is being liquidated and the assets being distributed in the way of liquidation that causes you to express the opinion that it might not be unwise to sell it?

A. There is another reason for that. A New York office will have to be maintained for years because it is a New York corporation. There is no way of stopping it; there are contracts out and it is entirely solvent; and unless it is an active, going concern there is no way of making any money out of it for ten years; and another thing, it is not often you can get an offer on a security business like that. I wouldn't know where else to go to to get an offer.

* * * * * * *

[fol. 2179] Q. Mr. Young, did you open up negotiations with Pell?

A. Yes.

Q. When did you open them up?

A. I have had them going on for two years.

Q. You opened up since June 6th?

A. No, two years I said.

Q. Have you talked with them since June 6th?

A. Certainly I have, many times.

[fol. 2180] Q. Representing the trustee?

A. Representing no one.

Q. As a matter of fact, this was taken up with Pell and gone into extensively away back yonder and they declined to have anything to do with it.

A. Yes, with Fidelity.

Q. Mr. Koontz was up there, and Mr. Foulk——

A. Mr. Clarke and I, and we had a two day session.

Q. And they said they were not interested.

A. Yes, and as far as the group of men—I may say Mr. Koontz knows the majority of the men on here and will vouch for them being very high grade men.

Mr. Palmer: And it is true that they said they would not invest any money in Fidelity, after looking at all of the picture, getting the data and everything about it.

A. Fidelity, yes, sir, but they offered to buy Fidel at that time.

Q. And they still offered to buy Fidel, and they will seriously consider Fidelity?

A. That is right.

[fol. 2181] Redirect examination.

By Mr. Ray:

Q. Do you know whether, prior to all this litigation in which Fidelity recently — been involved, a new contract was being prepared which was proposed to be offered for sale in which the improvement rate would be 3 per cent?

A. I think that is a fact.

Q. If such a contract had been offered for sale, do you think the company would have been able to perform its promises therein?

A. Under that contract?

Q. Yes.

A. I feel quite sure they would.

Mr. Ray: That is all.

Recross-examination.

By Mr. Reinhardt:

Q. Mr. Young, does this wire say it will be confirmed by letter?

A. Yes.

Mr. Reinhardt: We want to offer the letter when it comes. [fol. 2182] Mr. Palmer: We want to object to the letter coming into the record at all.

The Court: I overrule your objection.

The Witness: I wonder if you want put in the record the group who compose Pell, Limited?

Mr. Reinhardt: That is what I was going to ask you next. Mr. Young, will you furnish the reporter with the original of that letter when you have received it?

A. Yes.

Q. Can you tell us who constitutes this Pell, Limited, which signed this telegram?

A. I can't offhand, but I will be very glad to give you a complete list in the morning. Mr. Dickinson has it, and I thought he was going to be here this afternoon—about fifteen of them.

Q. Suppose you include that with the letter itself.

A. Yes, sir.

Re-cross examination.

By Mr. Farmer:

Q. You have been here all week?

A. Yes, sir.

[fol. 2183] Q. You have not talked with them since last week?

A. Yes, I have talked to them on the telephone. They made me an offer last week, and I asked them to confirm it, and they wouldn't do it until they got a balance sheet and income statement, which I sent them by air mail.

Q. Did you explain to them it would be impossible to find out whether the Court had jurisdiction within thirty days?

A. I told them I didn't know how long it would take. I could probably get that extended. I don't know.

Mr. Palmer: Q. Mr. Young, may I ask in these negotiations since the 6th of June, are you purporting to represent

the trustee, purporting to represent the group of gentlemen who are making the offer, or are you acting independently in the hope of getting a commission from one or the other?

A. No, I do not expect to get a commission from anyone. However, if someone else sold it they would ask for a commission. I am doing it like I would any other security I think should be sold. It is becoming a liability instead of [fol. 2184] an asset. You keep it six more months and Fidel will be losing money every month.

Q. Your position is you are acting as a former officer of Fidel in trying to get this sold? Is that right?

A. As I would any other security in our portfolio.

Q. Beg pardon?

A. As I would any other security in our portfolio.

Cross-examination.

By Mr. Reinhardt:

Q. Are you still in charge of the Fidelity portfolio?

A. I am working for the trustees.

Q. Do you still have duties with respect to the supervision of the Fidelity portfolio?

A. Yes, sir.

Mr. Palmer: Q. Then you are working for the trustee at the present time and in the sale of this asset?

A. No more than I would anything else in the portfolio. I am supposed to advise the trustee if I think something should be sold.

[fols. 2185-2186] Q. My question wasn't what you were supposed to do; my question was whether you were working for the trustee.

A. Certainly I am working for the trustee.

John Marshall, Sr. recalled, testified as follows:

Direct examination.

By Mr. Ray:

[fol. 2187] Q. Mr. Marshall, I hand you the minute book of the company, which has previously been marked Exhibit D for identification, with the understanding, I believe, that any pertinent minutes therein contained may be intro-

duced in the record as a part of the evidence. Will you please turn to page 154 to the minutes of a meeting of the directors held on December 23, 1940?

A. Yes, I have that.

Mr. Ray: We now want to offer the minutes of this directors' meeting in evidence and have it marked with the proper exhibit number.

Mr. Palmer: May I look at it before that is done?

(Witness hands book to Mr. Palmer.)

Mr. Palmer: Your Honor, we object to the introduction [fol. 2188] of these minutes. The purpose is obvious, that the minutes as signed by Mr. McNulty, set up that six directors present constituting a majority of directors. That doesn't have anything to do with whether the by-laws are correct in stating that seven is a majority and is so applicable.

The Court: Seven is a majority or a quorum?

Mr. Palmer: It says "constituting a majority of directors."

The Court: I don't remember anything in the by-laws that says seven is a majority.

Mr. Palmer: No, you are correct, your Honor— my mistake; but outside of that I can see no relevancy in the entire minutes, and if Mr. Ray will be kind enough to point out the relevancy perhaps I will agree to the introduction of it.

Mr. Ray: If it please your Honor, it shows the interpretation put on the by-laws of the company by the company, and it shows that the general attorney of the company, Mr. Foulk, was present at that meeting, and the presumption would be that that was his opinion that that was a proper interpretation of the by-laws. It is simply offered for [fol. 2189] what it is worth.

The Court: Well, if it is shown in this meeting that the company elected somebody else who constituted the seventh director, that would be admissible.

Mr. Ray: That is exactly what it does, and that is the purpose for which it is offered.

The Court: I overrule the objection. As I understand, Mr. Palmer still objects to that, even so.

Mr. Palmer: Yes, your Honor; this is merely the writing up of the minutes by Mr. McNulty, the secretary. I don't

find any other signatures by the board of directors on that minute book. The fact that it states that there was a majority of the directors doesn't have the slightest thing to do with the by-laws, which provide a certain way to form a quorum; and what the company did or what six directors did does not change the by-laws unless it was specifically so voted.

The Court: As I understand, Mr. Ray is not making any point of the statement that that constituted a majority of the directors.

Mr. Ray: No, your Honor.

The Court: Mr. Ray's purpose is to show that a meeting [fol. 2190] took place at which six directors were present, and that those six elected a seventh director, which constituted a quorum. I admitted evidence of that kind before, and I think, to be consistent, I will have to admit that now.

The Witness: Of course, I wasn't present at this meeting, your Honor——

Mr. Palmer: We object to having the rest of the minutes in that do not bear upon this particular question.

The Court: Well, that might have some bearing. I will let the minutes of that meeting be introduced.

EXHIBIT 91

The minutes of the meeting referred to were admitted in evidence, marked as above indicated. The same are attached hereto as a part hereof.

Mr. Ray: Q. Mr. Marshall, was a special meeting of the board of directors of Fidelity Assurance Association held, after being called and notice given, at 12 o'clock noon at the Daniel Boone Hotel, in the City of Charleston, West Virginia, on Wednesday, September 17, 1941?

Mr. Palmer: Objection.

[fol. 2191] A. That is correct.

Mr. Palmer: Any meeting held after the institution of this proceeding would be entirely irrelevant as to anything going on in these proceedings, so there would be no need of putting in any evidence about that meeting.

The Court: I don't know whether it would or not until we hear what happened at it. I overrule the objection.

Mr. Ray: What was the answer?

A. That is correct.

Q. Did you act as secretary of the meeting?

A. I did.

Q. Have you prepared the minutes of the meeting?

A. Yes.

Q. Do the minutes as prepared by you correctly show what took place at the meeting?

A. To the best of my knowledge and belief.

Q. Have you placed the minutes of the meeting in the minute book of the corporation?

A. That is right.

Q. On what pages of the minute book are those minutes? [fol. 2192] A. They follow the ratification, which is also placed in the minute book by Mr. Burt, between pages 176 and 177; and the minutes of this meeting of September 17th begin on page 177 of the minute book.

Mr. Ray: We now offer the minutes of this meeting of the board of directors in evidence.

Mr. Palmer: May we see them, your Honor?

The Court: Yes, go ahead. I would like to see them too before I pass on it.

Mr. Jaegerman: Your Honor, might that not be read off the record so we can hear what it is?

The Court: Yes, that may be done.

(The minutes referred to were read.)

Mr. Palmer: If your Honor please, I object. Mr. Wheeler Bachmann, who was mentioned there, was not qualified as a director at that time, having refused to qualify as a director prior to June 3, 1941.

Mr. Ray: Your Honor, that is a matter of fact that is not true because he says so. Here are the records of the corporation, and the records show that he was elected.

The Court: We have had this read, but, as I understand, [fol. 2193] it has not gone in evidence yet. Did you offer to introduce that in evidence?

Mr. Ray: Yes, I offered it before it was read.

The Court: Is your objection directed to the offer of Mr. Ray?

Mr. Palmer: Yes, your Honor.

The Court: I will overrule that particular objection, because I think Mr. Ray is right, in that there has been no showing made that such is the case.

Mr. Palmer: I think, your Honor, it was shown earlier

that Mr. Bachmann wasn't qualified as a director. I believe the answer of the Auditor under oath set that fact up, that Mr. Bachmann did not qualify as a director.

The Court: But there is nothing to show just what did happen with Mr. Bachmann.

Mr. Palmer: The answer says, "At the previous annual meeting of the stockholders of the debtor held on February 21, 1941, fourteen stockholders were elected to the board of directors, of whom four, namely, Arthur B. Koontz, Wheeler C. Bachmann, Walter T. Grosscup and Tom B. Foulk have either refused to serve as such or had resigned [fol. 2194] prior to the purported meeting held June 3rd, 1941." I do happen to know of my own knowledge that Mr. Wheeler Bachmann informed me that he had refused to qualify, and he informed me after the federal court proceedings were brought here, and he said he would not qualify because he did not have time to serve and had refused so to qualify. Until there is proof made of Mr. Bachmann's qualifying as a director, we object on that ground. We also object, if your Honor please, on several other grounds.

The Court: Well, let's take that ground first. What is your ground for saying that if he failed to qualify before June 6th he could not qualify afterwards?

Mr. Palmer: I don't know whether he resigned or refused to qualify, and those facts are set up in the Auditor's answer, but I would like to be given time to find out about that it is—nearly adjournment time—before the Court rules on this, so I can be fully advised as to the facts.

Mr. Ray: Your Honor, that is something he could show when he puts in his case. We bring you the minute book, which is presumptively correct. There are the minutes of [fol. 2195] the corporation. The minute book shows that he was elected. There is no record of a resignation. The minute book shows that he appeared at the meeting, that he made motions, and it certainly would be presumed that he qualified and was acting as a director; so certainly the minutes are entitled to be filed. If he wants to come along later and introduce evidence to show that he was not qualified, he would have a right to do it.

Mr. Palmer: If your Honor please, if I am not mistaken there is evidence in this case already that at the time of the meeting in Pittsburgh there were a certain numbers of directors, one of whom was not Wheeler Bachmann.

Witness after witness testified under oath as to all of the directors of the company, and that Wheeler Bachmann was not one of those directors at that time.

The Court: What I am asking you now is, on what do you ground your statement that if he wasn't a director at that time he can't have been a director on September 17th?

Mr. Palmer: There is nothing to show that he was re-elected to the board of directors since June 6th or that he [fol. 2196] was ever elected to the board of directors between June 6th and the present date; and the mere announcement by a writing such as his that he was a director does not make him so.

Mr. Kay: I think that is the best evidence of whether he was a director or not. I think that is the best evidence that can be produced as to whether he is a director; and the only way that it can be shown that he is not a director is to show that those minutes are false and incorrect.

Mr. Palmer: All right; here is the testimony of Mr. Messick, Chairman of the board, under oath, and he mentions those who were at the Pittsburgh meeting, and Mr. Burt and Mr. Risley absent.

"Question: And they were the other directors?

"Answer: Yes.

"Question: How did you arrive at that number? I think the minutes of the stockholders' meeting of that year, or the year previous, showed the election of 14 directors.

"Answer: That is right, but a number of the men elected as director did not qualify.

[fol. 2197] "Question: Refused to serve?

"Answer: Yes.

"Question: And that left these eight?

"Answer: That is right; that left eight.

"Question: At the time this meeting was held there were only eight directors?

"Answer: That is right.

"Question: And six of those were there?

"Answer: Yes, six were there."

The Court: But, Mr. Palmer, is it your position that because he failed to qualify at one time and therefore wasn't eligible to sit at that day, he couldn't come in later and qualify and sit in a meeting?

Mr. Palmer: Yes, your Honor, if the gentleman refused to qualify as a director and thereby refused acceptance of

that position, it left it open for a new one to be elected in his place.

Mr. Reinhardt: And suppose he failed instead of refusing?

Mr. Palmer: This says, "Refused to serve."

The Court: Well, he failed to qualify and refused to serve at first.

[fol. 2198] Mr. Ray: Those directors who were elected at the stockholders' meeting; some of *the* them didn't have the capital stock and couldn't qualify. Others, I think Mr. Bachmann and Mr. Grosscup, did have the capital stock; and they are directors, in our opinion, of this corporation until they resign and their resignation is accepted.

Mr. Palmer: If your Honor please, we have the Chairman of the board of directors under his oath in this proceeding stating that Mr. Wheeler Bachmann is not a director as of June 6th.

Mr. Ray: Where did he say he wasn't a director?

Mr. Palmer: If you will read the record, Mr. Ray——

Mr. Ray: You read it. What you read doesn't say it.

The Court: It seems to me all that says is that he was not at that time a qualified director.

Mr. Palmer: No, it says there were only eight directors at that time. Now, in order to make that man a qualified director now, there would have to be some action between the 6th of June and now, none of which is shown.

[fol. 2199] The Court: But may it not be presumed until you show the contrary?

Mr. Palmer: A condition once existing is presumed to continue until the contrary is shown, and it is shown that he was not a director, and that condition will be presumed to continue until proof is offered that he was a director.

The Court: I don't think it was shown that he was not a director; it just says up to that time he had not qualified.

Mr. Palmer: The record says there were only eight directors, and names them, if your Honor please, if I may read that.

"Question: Who were the members of the board of directors at that time?

"Answer: It was Mr. F. S. Risley and Mr. Austin King——

"Question: What about Mr. Burt?

"Answer: Mr. Burt, yes, of Wheeling.

"Question: Well, Mr. Burt and Mr. Risley were absent?

"Answer: They were absent.

[fol. 2200] "Question: And they were the other directors?

"Answer: Yes.

"Question: How did you arrive at that number? I think the minutes of the stockholders' meeting of that year, or the year previous, showed the election of 14 directors.

"Answer: That is right, but a number of the men elected as director did not qualify.

"Question: Refused to serve?

"Answer: Yes.

"Question: And that left these eight?

"Answer: That is right; that left eight.

"Question: At the time this meeting was held there were only eight directors?

"Answer: That is right.

"Question: And six of those were there?

"Answer: Yes, six were there.

"Question: How did it happen Mr. Burt did not come?

"Answer: Mr. Burt informed us he was attending a telephone meeting at Charleston.

"Question: What about Mr. Risley?

"Answer: Mr. Risley, I was informed, wired he was [fol. 2201] unable to be there."

And that is all the direct examination by the debtor of Mr. Messick, Chairman of the board, and now they attempt to contradict that.

Mr. Ray: We don't attempt to contradict anything, your Honor. We introduced the corporate record which shows that Mr. Bachmann was elected a director, that he came to this meeting, that he served as a director, and there is nothing in those minutes to show that his resignation was ever accepted. I am willing to ask the witness, if it is necessary, whether his resignation was ever accepted. I don't think it is necessary, because I think it will be presumed.

Mr. Palmer: A man doesn't become a director until he qualifies.

Mr. Ray: And I think in this case he qualified by coming to the meeting and serving as such, if he had the capital stock.

Mr. Palmer: And if he refused to serve there is a vacancy immediately created on the board of directors. The Chair-

man of the board has said there were only eight directors at the time of the meeting in Pittsburgh. If you want to [fol. 2202] bring in another man as director, you must bring in some proof of his election since that time.

The Court: Mr. Palmer, the Court is not going to pay any particular attention to the testimony referred to by Mr. Messick, because it is apparent that Mr. Messick was thinking of that occurrence from a different angle to the one from which you are thinking of it. Now, even if he is mistaken, the Court is interested in getting at the truth; so if Mr. Bachmann was a director, and was able to serve, then the fact that some witness in the proceeding said he was not would not interfere with the Court's decision.

I think the real ground of your objection that the Court would want to consider in determining whether to sustain it or not would be whether a director who is elected, by failing to qualify and refusing to serve at some particular meeting, thereby loses his office as a director without the necessity of any acceptance of his resignation or otherwise. It seems to me that is the legal point. Now, what is your position on that, Mr. Ray?

Mr. Ray: Your Honor, I say that all this record shows [fols. 2203-2210] is that Mr. Bachmann was elected a director at the stockholders' meeting in February. I think there were two directors' meetings at which he was not present. There is nothing in there about his refusing to qualify or refusing to serve. He just was not present at those meetings. Then at this meeting there is a minute showing he appeared as a director. He took part in the meeting, he made motions and voted and served as a director, and I say that record, which is the record in this case, clearly shows that Mr. Bachmann is a director of this company.

Mr. Huwe: Your Honor, may I be heard? What difference does it make that Mr. Bachmann didn't participate in the resolution with reference to the filing of the petition or a new petition? In other words, we had a quorum of seven without Mr. Bachmann.

Mr. Palmer: No, they didn't, not until they elected a new one.

. . . . . .

[fol. 2211] The Court: Gentlemen, the Court is ready to take up any motions that are proper to be taken up at this time.

(Several motions in writing which had previously been filed were thereupon argued by counsel, off the record.)

Stipulation

Mr. Eney: Your Honor, for the purpose of my motion I would like to have it stipulated that figures shown by the exhibit previously introduced, that the par value of the Maryland deposit as of June 6, 1941, was $600,000; that its market value as of that date is $470,806.25; that the net reserve liability of Fidelity Assurance Association to the Maryland contract holders is $508,163.70; that the net cash liability is $492,552.24; and the term "net" in connection with both the reserve liability and cash liability means the total liability less the amount of loans made to contract [fols. 2212-2315] holders.

The Court: Isn't that already in the evidence?

Mr. Eney: It is in evidence in the other case, but my motion is no part of the other case, and I wanted it for the purposes of this case.

* * * * * * *

[fol. 2316] H. Isaiah Smith recalled, testified as follows:

Cross-examination.

By Mr. Lauritzen:

Q. Mr. Smith, there has been some testimony here con-
[fol. 2317] cerning federal income tax liability of Fidelity Assurance Association with respect to a certain deficiency assessment that has been levied. Can you give us any information on that?

A. During the period of the state court receivership the Internal Revenue Department sent their agent in to work up a report on the income of the company from 1935 up to date, and there was an assessment made of approximately—I think $265,000. Before the time expired for appealing the case the trustee was appointed and an extension was granted for filing the return, and at the present time auditors have been engaged in going into the matter and seeing

whether or not it is the correct amount, and then—with the thought in mind of fighting the case clear through to the Internal Revenue Commissioner.

Q. By auditors do you mean employees of the trustee in this case?

A. No, an independent auditor has been employed.

Q. Has been employed by the trustee?

A. Yes.

Q. Who are they?

[fol. 2318] A. Haskins and Sells.

Q. Can you tell me for what years this deficiency assessment was levied?

A. From 1935 to and including 1940.

Q. That is for the income tax years 1935 to 1940, inclusive?

A. That is right. I know it begins in 1935. I think it includes 1940.

Q. Is that an assessment that is levied against Fidelity as a whole, as a corporate entity, or is it levied against some fund or intra-corporate entity of some sort?

A. It is levied against Fidelity as a whole. However, the tax is computed on the income of the various reserve funds, but I repeat the assessment is made against Fidelity Assurance Association as a whole without any breakdown with reference to the various reserve accounts.

Q. Can you tell me whether they charge that the so-called general fund had any income in any of those years?

A. No, I don't know.

[fol. 2319] Q. Mr. Smith, you previously prepared a certain statement which has been introduced as Exhibit 48, showing the deposits by states as of June 6, 1941 and the liabilities by states as of that date. You are familiar with that?

A. I believe the liabilities as of April 10th.

Q. Oh, yes, excuse me; liabilities as of April 10, 1941. Now, you list the total market value of deposited securities at $20,056,680.27. Then under that there is an item entitled "Not deposited securities," having a market value as stated here, of $556,467.51. Can you tell me what is the nature of those securities and what is the reason that they were not deposited?

A. That is on deposit as of June 6th?

Q. Yes, sir.

A. Those were securities that we had in Wheeling that were turned over to the trustee on June 6th. Most of them belonged to the general fund. Some were common stocks and there was some mortgages, and, oh—a few odd lots of FHA mortgages probably that belonged to the—not particularly FHA mortgages, either, but just odd lots of securities that were not on deposit belonging to the con-
[fol. 2320] tract funds. The amount would be insignificant, however.

Q. They have a total market value of $556,000?

A. I meant in securities that belonged to the contract funds. Most of the five hundred and odd thousand are securities belonging to the general fund. Does that answer your question?

Q. Yes, almost. Can you tell me how these securities happened to be there in the general fund and not on deposit?

A. The general fund securities were not required to be on deposit, is my understanding.

Q. Can you tell me whether these securities comprising this $556,000 item would be eligible for deposit under the laws of the various states?

A. Most of that was not eligible.

Q. You say some of those are common stocks. What sort of common stocks?

A. I can't name offhand the companies, but I do know that there is some Wheeling Steel and Hartford Rayon and various common stocks. I can't name them offhand.

Q. Were these stocks purchased over a long period of
[fols. 2321-2329] time by the general fund, if you know.

A. I don't know.

• • • • • • •

[fol. 2330-2337] Mr. Palmer: Oh, yes, I presume he will get that.

I am not certain that this has been asked. If it has, the Court will stop me. It is true, is it not, that you, as a state court receiver, did not receive any of the state deposit fund that was under the control of Mr. Sims, but he retained that all during your state court receivership?

A. That is correct.

• • • • • • •

[fol. 2338] Mr. Palmer: We are going to ask the Court's permission to call the gentleman who is here from the State of Ohio as its official representative to state on the witness stand what happened to this proceeding and how they were taken care of, in order to show the Court that they will not interfere with proper proceedings by statute.

The Court: That will be all right. It will not be necessary for him to take the stand. Let him state his name and his official capacity.

Mr. Dunifon: My name is Dale Dunifon and I am First [fol. 2339] Assistant Attorney General of the State of Ohio.

If the Court please, in Ohio with reference to the liquidation of deposits of insurance companies and bond investment companies, our law has been held to be exclusive by both the Supreme Court of Ohio and the Federal Circuit Court of Appeals of our circuit. A receivership action was instituted in the Common Pleas Court of Franklin County by John A. Lloyd, Superintendent of Insurance of Ohio and, by virtue of his office, supervisor of bond investment companies, at the request of either the State Auditor of West Virginia or the state court receivers, I am not sure which. That receivership proceedings was for the sole and exclusive purpose of taking possession of and protecting assets of less than $10,000, which represented cash in banks, furniture and other small assets throughout the state, and had no connection whatever with the statutory deposits and was not the type of proceeding that would subject those deposits to liquidation, and the superintendent of insurance only took control over assets totalling some six or seven thousand dollars.

The Court: Was this proceeding ancillary to the West [fol. 2340] Virginia proceeding?

Mr. Dunifon: He asked for an ancillary receiver in Ohio, yes, sir.

After that suit had been filed for some several weeks and after the restraining order approved by this Court—I may be wrong in the date, but I think after the date of this Court's action—Mr. Huwe and Mr. Rivers appeared before that Court as the Court related to me, because we were not notified, and during a recess obtained the right to intervene, or rather file a cross petition. Prior to that both the super-

visor of bond investment companies and the Attorney General's office had received letters and telephone requests from Mr. Rivers and Mr. Huwe to proceed at once to liquidate the Ohio deposit, because the people they represented were not interested in any type of reorganization.

After the hearing in the Common Pleas Court we were notified the next day by reading the Daily Reporter, that the Treasurer of State had been made a party defendant, and that in the cross-petition of Mr. Huwe and Mr. Rivers they sought to liquidate the two statutory deposits in Ohio. [fol. 2341] I then called to the Court's attention, by telephone, the restraining order that had been put on in this cae. It was then that he explained that he had been in the trial of a criminal case, that representations were made that these gentlemen were from out of town and it was rather a pro forma matter and the Attorney General's office needn't be notified of it in advance.

The Court then instructed the Attorney General's office to notify Mr .Huwe and Mr. Rivers that he felt that they had taken advantage of him, and that they should, of their own motion, ask to have the order vacated. Mr. Rivers was called by telephone and he said he would get in touch with Mr. Huwe, and they promised to take immediate action. Some eight or ten days went by and the Court called me and asked me what had happened to these lawyers. He then told them that if they were not present in Court by such and such a day the order would be vacated. They then appeared in Court on that day, Mr. Huwe and Mr. Rivers. The argument was presented by the Attorney General's representative's that in that type of action, which was not a mandamus action, which their clients had the right to [fol. 2342-2343] resort to, but that was not the type of action that this was—and only by making a demand on the supervisor of bond investment companies or the Attorney General, and then attempting to mandamus them, could they have those deposits in Ohio liquidated. Cases were cited, and the Court then entered an order nunc pro tunc which vacated the previous order making Mr. Huwe's and Mr. Rivers' clients parties, and that case has now been closed and the costs paid.

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[fol. 2344] Q. Mr. Smith, you testified that there were certain assets which the West Virginia State Court Receivers

[fol. 2345] took over upon their appointment and others that were in the State of West Virginia which they did not take over. Is that correct?

A. That is right.

Q. What is the difference between those two groups of assets?

A. Well, the assets that we took over was the cash in banks, securities—undeposited securities in the Wheeling office and certain undeposited securities in the bank vault of the Dollar Savings and Trust Company. The assets we didn't take over were the assets on deposit with the State of West Virginia.

Q. Why not?

A. Well, so far as I know, Mr. Reinhardt, there was no formal demand—in fact, there was no formal demand made for those securities by the receivers.

Q. Why wasn't there a formal demand made?

Mr. Palmer: That may be a legal question, your Honor, that perhaps Mr. Smith can't answer. I am not suggesting that it is.

A. Mr. Palmer, I was just about to say that the attorneys [fol. 2346] for the trustee had not given us advice in any way as to how to acquire those securities or whether or not it was our responsibilities to take them into our possession.

Mr. Reinhardt: You mean the attorneys for the receivers?

A. Pardon me—attorneys for the receivers.

Q. That is, when you refer to the attorneys for the receivers, you mean Mr. Thomas?

A. Mr. Thomas was a co-receiver—one of the receivers—and I counselled with him on legal matters.

Q. Who did you refer to when you say "The attorneys for the receivers"?

A. The attorneys for the receivers are the firm of Koontz & Koontz.

Q. Mr. Thomas was then a member of Koontz & Koontz?

A. I presume that he was. I didn't have any knowledge of him resigning from the firm.

Q. Did the question ever arise in any discussion that you had, either with Mr. Thomas or with any other member of the firm of Koontz & Koontz, as to what the duty of the receivers was with respect to taking possession of the assets

[fol. 2347] that were on deposit with the State of West Virginia?

A. That was never discussed, to my knowledge.

Q. Did you exercise any control or did you have any conversations with anybody respecting the assets that were deposited with the State of West Virginia?

A. You mean with reference——

Q. As a receiver.

A. You mean with reference to taking possession of them?

Q. Any kind of conversations about them at all.

A. No, other than the discussion I had with the State Auditor with reference to letting us withdraw the stock certificates issued in the name of the association representing the capital stock of Fidel. We wanted the stock transferred to our names, and the Auditor permitted us to make that exchange, substituting the certificate issued in our name for the one that was on deposit with the State Treasurer.

Q. You know about these deposits of West Virginia securities?

A. I certainly did.

Q. But the question of whether you should take posses-
[fol. 2348] sion of them never occurred to you?

A. No, sir.

Q. Had you formed any opinion as to what your duties as receiver were with respect to those assets?

A. No. I was depending on the advice of counsel, if we were supposed to take them into our possession.

Q. Well, as receiver you contemplated that some time there might be a distribution of the assets that you were administering?

A. Oh, certainly.

Q. Did you ever consider what assets would be distributed and how and whether they would include these deposited securities?

A. I most certainly did.

Q. Did you talk about it to anybody?

A. You mean about the possibility of selling and distributing the assets?

Q. Of you as receiver doing that.

A. Yes. Of course, as receiver I knew these assets were property of the—of the association, and if and when the

time came that we were to liquidate it would be necessary [fol. 2349] for us to acquire possession of them in order to dispose of them.

Q. That includes the assets that were deposited with the State of West Virginia?

A. That is right.

The Court: I think the question was whether he had ever conferred with anybody.

Mr. Reinhardt: I was going to follow that up.

Q. Did you discuss that with anybody?

A. Oh, Mr. Thomas and I, of course, discussed those general policies as to what we could do in the case we couldn't work out a plan of reorganization, that it would be necessary to liquidate the securities, but as to the mechanics of getting those securities into our hands, there was no definite policy established on that at all.

Q. Well, I wonder whether that is true, in the light of what you say. Was it the decision that you arrived at in your conferences with Mr. Thomas that pending efforts to work out a plan of reorganization, the securities deposited with West Virginia might be left where they were and then if you worked out, or if a plan of reorganization were worked out in the receivership which required anything to [fols. 2350-2353] be done with those deposits, that would be the time to——

A. That is what I intended, Mr. Reinhardt, my answer to be to your question.

Q. So that there was that definite policy?

A. Yes, sir.

Q. It may not have been adopted as a statement of policy, but that was your conduct with regard to those securities?

A. Yes, sir.

Q. But also, if there were no reorganization in the state court, but a liquidation, that at that time you would have to take over these deposited securities and liquidate them?

A. That is right. I might further add, I stated that the only time we entered the boxes, the deposit boxes of the securities—was when this exchange of the Fidel stock certificates, but we did ship down to Charleston securities worth approximately—the market value was approximately $500,000 and placed them on deposit. That was along about the 8th day of May. And then we cut the matured coupons for the month of April, I believe.

[fols. 2354-2358] Q. Up until the time that you were superseded as receivers you hadn't even got to the point of being able to start on any plan of reorganization, had you?

A. Oh, most certainly not. As a matter of fact, the life of the receivership was less than two months, and we were making preparations for an audit of the firm so that we could see just where we stood in order to be able to give some thought to a plan of reorganization.

Q. So that you were just barely beginning your duties when you were superseded? Is that right?

A. I should think that is perfectly obvious, that with a concern of this size we didn't have time to have any plan worked out.

Q. With reference to the state deposit in West Virginia, as receivers you never made any demand on Mr. Sims for that fund, did you?

A. No, sir.

[fol. 2359] Q. So that the ultimate question of who should convert the securities into cash had not been presented by you as receiver to your legally appointed counsel for the purpose of their determination?

A. I believe I have previously so stated.

Q. And the question of whether or not you were an agent of Mr. Sims or were a receiver of the state judicial branch of the state government had not been discussed or determined by your counsel? Isn't that true?

[fol. 2360] A. No, it had not been determined by counsel. I just as a layman had assumed that I was an officer of the Court, and so regarded myself.

Q. And it was just your own opinion and not the legal opinion rendered to you as receiver?

A. That is right.

Q. If it had been ultimately determined in the state court proceeding that no reorganization could be had, were you and Mr. Thomas prepared to do whatever you were legally advised was the law with reference to liquidating any securities and distributing the proceeds thereof?

A. Yes.

Q. Do you know, of your own knowledge, how far anything had been done towards starting to formulate any plans of reorganization?

A. You mean any state? Had been planned by any state?

Q. No, any plan of the receivers, you and Mr. Thomas,

whether you had talked of any, thought of any or begun to formulate any, or what the situation was.

A. Oh, yes, we had talked about a plan, but we had not [fol. 2361] been able, or didn't have time, of course, to work it out, but it had been under discussion many times.

Q. And was it your intention to attempt to formulate some plan of reorganization in the state court?

A. That was our intention, yes.

The Court: Mr. Smith, in discussing the plan between you and Mr. Thomas, what part in that plan did the deposits with the State of West Virginia have?

A. Well, we—in discussing—in discussing a plan we first had in mind to work out a plan in which all the assets of the association would come into us, or the state receivers would work with us, realizing from that standpoint that if we had obstacles of any other state attempting to liquidate or failing to cooperate with us, that that would affect our plans, we would have to go back and work it over to take into account the securities that might be on deposit in that particular state.

Q. That is with reference to the outside states. I am asking you now what part in this plan was played by the deposits that you had in the State of West Virginia—that Fidelity had in the State of West Virginia?

[fol. 2362] A. We had not gotten that far, your Honor, as to just how we would proceed if and when it was determined that the only deposit we could administer would be the West Virginia deposit. We had not gotten that far along.

Q. But whatever plan you had under consideration involved administering by the receivers of this lot of securities that was on deposit with the State of West Virginia, didn't it?

A. Your Honor, we felt that we could administer this deposit, but any such plan as we had talked about took in the securities in all the states, with the hope that we could secure co-operation with the state authorities or receivers that might be in other states; so, as I say, we had not talked of a plan that would just confine it to the West Virginia deposit alone.

Q. Well, it was your theory, was it not, that you could handle these securities in West Virginia, including the securities on deposit with the state—could handle those

by virtue of your appointment by the Circuit Court of Kanawha County, and the others, if they came in the plan, would have to come voluntarily through action of the various state depositories and receivers?

[fol. 2363] A. That is right.

The Court: All right.

Mr. Palmer:

Q. Mr. Smith, isn't it rather the fact that you contemplated that Auditor Sims would co-operate with you in any plan that you formulated and would agree to go along with anything that you thought reasonable?

A. Yes, we anticipated discussing freely with Mr. Sims such plans as we might formulate.

Q. When you informed the Court that you had contemplated the administering of this fund, you didn't mean to tell him, did you, that you contemplated physically taking it from Mr. Sims' possession, but rather that you contemplated having a plan with which he would agree and go along?

A. I don't believe I understand your question, Mr. Palmer.

Q. What I want to know is, did you in your own mind first contemplate a reorganization plan which contemplated you, as a receiver, physically taking the assets in the State of West Virginia on deposit there into your possession and administering them, or did you contemplate in that reorganization plan presenting the plan and having Auditor [fol. 2364] Sims agree to go along with your plan?

A. We had not anticipated taking physical possession of the securities, but we certainly anticipated that we would have control of them to the extent of fitting them into the plan, but as for taking physical control, why, I believe I have previously said that we had no advice on that matter at all.

Q. And your plan that you hoped to effect was that not only Mr. Sims but all of the other state officials where there were deposits would agree to co-operate and allow a pool to be formed upon which the plan could operate?

A. That is the only way it could be done.

Mr. Reinhardt: That is contrary to the witness's answer to the immediately preceding question.

Mr. Palmer: What was his answer to this question?
Mr. Reinhardt: I am objecting on that ground.
The Court: Read the question.

(The question was read.)

The Court: If the witness understands that question I will permit him to answer.
A. I believe in reply to the Court a while ago I answered the substance of that question.
[fol. 2365] The Court: He said a while ago that he contemplated that while they probably would not take physical possession, that they would have control. If this question is explained to the witness I will permit it to be asked and answered.
Mr. Palmer: What was the answer?
The Court: Let's hear the question.

(The question and answer were read.)

The Court: Do you mean by that answer, Mr. Smith, that you now retract what you said about the receivers having control of the state fund?
A. No, your Honor. When he referred to a pool pooling all the assets I didn't understand that question to mean that that required all the assets to be brought in.
Mr. Palmer: No, not physically, but to be available for the purposes of the plan left where they were. Wasn't that your attempt?
A. If I understand your question aright, Mr. Palmer, my answer was designed to—strike that—my answer was supposed to have been, or is, that if we were to work out a plan that we would ask the co-operation of all the state [fol. 2366] officials and holding in status quo these securities until such time as the plan was accepted by the contract holders.
Q. And then you would ask the state officials to allow that plan to operate on the contract holders and the fund in their states?
A. I believe that is covered in my answer.
Q. Is my understanding of it correct?
A. Yes, sir.

The Court: Let me make this observation. This line of testimony, as I see it, although the purpose of it has not been explained, the only purpose that I can see to be at-

tained by this sort of testimony is to find out what the policy and the attitude and the opinions of the receivers were before the proceeding was begun in federal court with reference to whether or not they had the right to administer this fund on deposit in the State of West Virginia. The only bearing that that would have, as I can see it, is that if while they were state receivers and in charge of the assets of the company that was their policy and that was their attitude and that was the position they took, then [fol. 2367] they should not be permitted to come into this proceeding and take an inconsistent attitude. If the Court has the right slant on the purpose of that testimony I would like to know, or if I don't have I would like to know.

Mr. Palmer: No, your Honor, we don't want the opinions of any witness.

The Court: No, I don't mean their opinions now. I mean their testimony now of what their opinions were then.

Mr. Palmer: No, your Honor, I have not asked that. That was developed by Mr. Reinhardt. I don't think it is pertinent or proper. I think that what the law of West Virginia was at that time is the only guiding factor that could guide this Court or could have guided those receivers, regardless of their personal opinion; that the statutory law of West Virginia was binding up on them and the State Auditor. What I have attempted to ask Mr. Smith is to show what these receivers were actually trying to do, in order to show to this Court that there was a pending proceeding in which a proper remedy for this debtor could have been had and was being attempted to be had when this came in. I want the facts and not opin- [fol. 2368] ions other than the fact as to what they were then doing and attempting to do. I do not want the opinion of the witness as to the legal situation between himself and the state court and the State Auditor, and I think that that is a matter of law which the state statutes clearly decide and not a question of opinion for either lay witness or expert witness or otherwise.

The Court: Then you and counsel for the SEC are approaching this matter with different purposes in mind?

Mr. Palmer: Apparently. I am approaching it, as I will state to the Court—I don't think the questions of the gentleman from the SEC as to the opinion of the witness are pertinent at all to the matter I am trying to develop.

Mr. Reinhardt: I share Mr. Palmer's approach to this particular question and I am glad to hear him say he did not want this witness's opinion on legal questions, because that was certainly the impression his question gave me, and that was the basis on which I object to this last question because it was designed, if I understand it correctly, to bring out the witness's opinion as to what would hap-
[fol. 2369] pen in the event a difference of opinion developed between the receivers and the State Auditor as to the desirability of a particular plan of reorganization. That, I think, is a question of law, and I don't think this witness should be asked about that, or, if Mr. Palmer wants to ask him about that, he should ask him so the witness understands what he is asking.

Mr. Palmer: Mr. Reinhardt and I are in perfect agreement. I don't intend to frame my question to bring out such a conclusion.

The Court: If you are agreed don't argue any further.

Mr. Palmer: Mr. Smith, you have told us it was your intention to form a plan. What I want is the fact whether or not you intended to have your plan suggest that it would, so far as possible, affect all of the various state funds and all of the contract holders in the various states as a joint jackpot or group of all the contract holders in all the funds. Is that question clear or not?

A. I believe I understand it. Our plan, of course, would take in as a group all of the assets of all of the funds in
[fol. 2370] all states, and that would be the basis for our plan. We also had discussed from time to time if we were not able to——

Q. Let me ask you a question——

Mr. Ray: Let him finish his answer, please.

Mr. Palmer: Go ahead.

A. And if we were not able to secure the cooperation of any state we knew that would affect materially any plan, and we would have to go back and build over it again. For instance, one state in question that we had talked about frequently, was Wisconsin, where they were liquidating the deposit. We knew that would affect materially Series B contract holders, for instance, because there was an excess of securities on deposit in that fund in that state, and there was an excess in some other funds and a de-

ficiency in others. Then we would have had to start all over by eliminating Wisconsin, and that would affect our securities in practically all the funds.

Q. So that, as well as having a general plan in mind which would affect all the states and all of the contract holders, you also were attempting to work towards some-
[fol. 2371] thing so that if any state or any group of contract holders would not co-operate with you, that you could still go along towards some plan of reorganization?

A. We knew it was a possibility that we might have that kind of situation arise and would have to adjust our plan to fit the situation.

Q. And you said all you had was the barest talk that you had to make a start towards these plans but had not been able to make any start towards formulating them? Is that right? . .

A. I think the only way a plan could be worked out——

Mr. Palmer: Read him my question and let him answer.

The Court: I believe he is trying to answer.

The Witness: My intentions were to answer the question, I believe before any plan could be worked out we would have to treat the situation as a whole, all the assets and all the liabilities.

Mr. Palmer: Will you read my question, please?

(The question was read.)

The Witness: Have I answered it?

[fol. 2372] Mr. Palmer: No.

The Court: I don't think you answered that.

The Witness: I don't understand the question.

Mr. Palmer: Let me rephrase it, that you had generally discussed that there should be a plan of reorganization, a broad plan which would include all of the states and all of the contract holders and all of the funds, and also the other possibilities that certain states and certain groups might not work with you, but outside of having that general talk and that broad idea, you had not yet been able at the time you were relieved as receivers, to formulate any plan leading toward that result? Isn't that true?

A. No, certainly not, because the State of Wisconsin had advised us that they would give us, until, I believe, June 30th to submit a plan of reorganization. As I recall off-

hand, it was June 30th. Of course, we were relieved on June 6th and never got to it.

Q. Mr. Smith, let me ask you this, had you either determined by discussion between you two as receivers or by discussion with your counsel whether or not a plan should be worked out which would treat each series as a separate [fol. 2373] entity or whether or not the entire groups should be treated as one entity regardless of series, or whether state lines and state deposits should govern? Had you discussed or decided upon that, or had a chance to discuss and decide on it with your counsel?

A. We had discussed it, but I don't recall having the advice of counsel as to what we could finally do.

Q. Had you discussed it, however, enough that you had reached any conclusion, or did you need legal advice to reach any conclusion?

A. No, we had not.

Q. In other words, everything you had done up to the time you were relieved was principally the collecting of the assets rather than any ultimate work on formulating something to do with them? Is that right?

A. Yes, we had spent a good deal of time in trying to corral the assets, and we had laid plans for an audit, as we felt we needed an audit to determine the exact status of each contract fund as of the date of our appointment.

Q. That was one definite plan that you had determined upon?

[fol. 2374] A. Yes.

Q. Had you had sufficient conferences with Auditor Sims to feel that he would co-operate with you in everything that you did that was legally correct?

A. I had discussed it personally with Mr. Sims a number of times—some notion of the plan—and he never gave me any idea that he would not co-operate. In the absence of having a definite plan worked out, however, I can't answer as to what he would have done about that.

Q. Were you in touch with the various officials of the states in which there were deposits?

A. You mean as receivers?

Q. Yes.

A. They had—different states had written us from time to time. We had, as receivers, never made a formal request for them to appoint ancillary receivers or receivers.

Q. I realize that. It is in evidence that Mr. Sims sent a telegram to them asking for that.

A. Yes, sir.

Q. My question is whether you were in touch with the proceedings, statutory or judicial, in other states, in which [fol. 2375] there — deposits of Fidelity.

A. We knew proceedings had been undertaken in other states and——

Q. And were you in touch with those who were in charge of those? Did you have correspondence, say with Wisconsin, the state officials there?

A. I think the counsel had correspondence with the State of Wisconsin.

Q. All right. Did you have corresponde-ce or a telephone call from the State of Ohio?

A. Yes. As a matter of fact, Mr. Lloyd came over to see us one day.

Q. Or the State of Missouri?

A. Mr. Godfrey came to Wheeling to see us.

Q. That is my question. Were you in touch with the various persons in different states in which there were deposits?

A. Those are the only three that I recall offhand.

Q. Those are the only three?

A. Yes.

Q. How about Pennsylvania?

A. Oh, one of the ancillary receivers from the Western [fol. 2376] District did come down to Wheeling to see us, too.

The Court: Was that an ancillary receivership?

A. I say ancillary. I believe at the last hearing I was disqualified on knowing what an ancillary receiver was, but in the petition of appointment over there they were called ancillary receivers.

The Court: All right.

Mr. Palmer:

Q. How about Maryland? Were you in touch with the State of Maryland?

A. No, I don't recall that.

Mr. Palmer: That is all.